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A Reconsideration of the Stock Market Exception to the Dissenting Shareholder's Right of Appraisal

All current corporation statutes accord shareholders the right to dissent from certain fundamental corporate actions, such as merger, consolidation, or sale or exchange of a large portion of the corporation's assets.¹ A dissenting shareholder can demand that his stock be appraised² and can require the corporation to purchase his stock at its appraised value.³ During the past decade, however, at least twen-

1. *See, e.g.*, IOWA CODE ANN. § 496a.77 (Supp. 1975); ME. REV. STAT. ANN. tit. 13-A, § 908.1 (1973); R.I. GEN. LAWS ANN. § 7-1.1-73 (Supp. 1974); VA. CODE ANN. § 13.1-75(a) (Supp. 1975).

2. Several states and the Model Business Corporation Act [MBCA] allow appraisal when a sale in dissolution occurs, but not when the sale is pursuant to a court order or is for cash on terms requiring that most or all of the net proceeds be distributed to the shareholders according to their respective interest within one year after the date of the sale. *See, e.g.*, ME. REV. STAT. ANN. tit. 13-A, § 908.1.B (1973); MICH. COMP. LAWS ANN. § 450.1761(b) (1973); W. VA. CODE ANN. § 31-1-122 (1975); 2 ALI-ABA MODEL BUS. CORP. ACT ANN. § 80(b) (1971). Some jurisdictions are more eager to facilitate corporate reorganization and have narrowed the range of actions that will trigger the appraisal remedy. *See, e.g.*, DEL. CODE ANN. tit. 8, c. 262(b) (1975) (provides for appraisal only in cases of merger or consolidation; this allows a corporation to effect a merger through a sale of assets); FLA. STAT. ANN. § 608.23(1) (Supp. 1975) (merger or consolidation only); LA. REV. STAT. ANN. § 12:131(A) (West Supp. 1969) (denies the right to dissent if the corporate action is approved by shareholders possessing 80 per cent or more of the voting shares). Some jurisdictions, however, allow appraisal for a broader range of circumstances. *See, e.g.*, TENN. CODE ANN. § 48-909(1)(b) (Supp. 1974) (lease of corporate assets); IND. CODE § 23-1-6-5 (1972) (sale, lease, exchange, mortgage, pledge or other disposal of corporate fixed assets); MD. ANN. CODE art. 23, § 73a (1973) (amendments to corporate charter that alter contract rights); N.Y. BUS. CORP. LAW § 806(b)(6) (McKinney Supp. 1975) (alters or abolishes certain contract rights).

If the right to appraisal is triggered, the assessment of a share's value may be performed by the court, *see, e.g.*, ILL. ANN. STAT. ch. 32, § 157.70 (Smith-Hurd Supp. 1975); MO. REV. STAT. § 351.455.3 (1966); NEB. REV. STAT. § 21-2080 (1974), or by a panel of court-appointed appraisers, *see, e.g.*, DEL. CODE ANN. tit. 8, § 262(c) (1975); NEV. REV. STAT. § 78.510(1) (1973); TEX. BUS. CORP. ACT art. 5.12C (Supp. 1975). If the appraisers are appointed, they may have authority to determine the share's value, *see, e.g.*, IDAHO CODE § 30-150(2) (1967); N.H. REV. STAT. ANN. § 294:78 (1966), or may be limited to simply recommending a value for consideration by the court, *see, e.g.*, DEL. CODE ANN. tit. 8, § 262(f) (1975) (court hears exceptions to appraiser's report and decrees value); NEV. REV. STAT. § 78.510(2) (1973) (appraiser's report final unless exceptions made). In some states, the use of appraisers is at the discretion of the court. *See, e.g.*, VT. STAT. ANN. tit. 11, § 2004(e) (1973); WIS. STAT. ANN. § 180.72(6) (Supp. 1975).

The stock valuation date also varies. A majority of jurisdictions value the stock as of the day prior to the vote approving the action. *See, e.g.*, OKLA. STAT. ANN. tit. 18, § 1.159(2) (1953). However, the effective date of the action, the date of the vote, and other dates are also used. *See, e.g.*, KAN. STAT. ANN. § 17-6712(b) (1974); MD. ANN. CODE art. 23, § 73a (1973).

3. Jurisdictions use a variety of statutory definitions of the payment that the appraisal is to determine. Some states use "value," *see, e.g.*, DEL. CODE ANN. tit. 8, §

ty states⁴ have withdrawn this right with respect to shareholders whose stock is listed on a stock exchange or is otherwise actively traded.⁵ Shareholders who come within this so-called stock market

262(f) (1975); IND. CODE § 23-1-6-5 (1972); KAN. STAT. ANN. § 17-6712 (1974), or "fair value," *see, e.g.*, ALA. CODE tit. 10, § 21(73) (Supp. 1973); ARK. STAT. ANN. § 64-707 (1966); IOWA CODE ANN. § 496A.78 (1962); ME. REV. STAT. ANN. tit. 13-A, § 909(1) (1973); VT. STAT. ANN. tit. 11, § 2004 (1973). The Model Business Corporation Act is in accord with these latter jurisdictions. *See* 2 ALI-ABA MODEL BUS. CORP. ACT ANN. § 81 (1969). Other states use "fair cash value." *See, e.g.*, FLA. STAT. ANN. § 608.23 (1956); MINN. STAT. ANN. § 301.40(2) (1969); NEV. REV. STAT. § 78-510 (1973). OKLA. STAT. ANN. tit. 18, § 1.159(2) (1953) uses fair value, but defines fair value as market value. Under the Oklahoma statute, if the stock is listed on a recognized stock exchange and any shares are sold on the day preceding the vote authorizing the proposed action, fair value is the highest price at which the shares were sold on that day (in the absence of fraud or collusion).

4. By the author's count, 18 of the statutes are in effect: DEL. CODE ANN. tit. 8, § 262(k) (1975); FLA. STAT. ANN. § 608.23(4) (Supp. 1973); GA. CODE ANN. § 22-1201 (Supp. 1975); IOWA CODE ANN. § 496A.77 (Supp. 1975); KAN. STAT. ANN. § 17-6712(k) (1974); LA. REV. STAT. ANN. § 12:131 (West 1969); MD. ANN. CODE art. 23, § 73a (1973); ME. REV. STAT. ANN. tit. 13-A, § 908 (1974); MICH. COMP. LAWS ANN. § 450.1762 (1973); PA. STAT. ANN. tit. 15, § 1515(L) (Supp. 1975); NEB. REV. STAT. § 21-2079 (1974); N.J. STAT. ANN. § 14A:11-1 (Supp. 1975); R.I. GEN. LAWS ANN. § 7-1.1-73 (1970); TENN. CODE ANN. § 48-909(3) (Supp. 1974); UTAH CODE ANN. § 16-10-75 (1973); VA. CODE ANN. § 13.1-75 (Supp. 1975); WIS. STAT. ANN. § 180.72 (Supp. 1975); IND. CODE § 23-1-6-5 (1972). Arizona will be the nineteenth state, ARIZ. REV. STAT. ANN. § 10-080(c) (eff. July 1, 1976) (West Leg. Serv. 1975) (no appraisal if stock is listed on national securities exchange or is held by at least 2000 shareholders), and California will be the twentieth state, CAL. CORP. LAW, ch. 682, § 1300(b)(1) (Deering's Cal. Codes, Advance Leg. Serv., 1975 Spec. pamphlet).

5. Most stock-market exception statutes require that the stock be listed on a national securities exchange in order to invoke the exception. *See, e.g.*, DEL. CODE ANN. tit. 8, § 262(k) (1975); FLA. STAT. ANN. § 608.23 (Supp. 1973); GA. CODE ANN. § 22-1201 (Supp. 1975); IOWA CODE ANN. § 496A.77 (Supp. 1975); KAN. STAT. ANN. § 17-6712(k) (1974); LA. REV. STAT. ANN. § 12:131 (West 1969); MD. ANN. CODE art. 23, § 73a (1973); MICH. COMP. LAWS ANN. § 450.1762 (1973); NEB. REV. STAT. § 21-2079 (1974); N.J. STAT. ANN. § 14A:11-1 (Supp. 1975); VA. CODE ANN. § 13.1-75 (Supp. 1975); WIS. STAT. ANN. § 180.72 (Supp. 1975); IND. CODE § 23-1-6-5 (1972). Statutes in Maine and Tennessee state that the exception applies to stocks traded on "national securities exchanges as defined by the S.E.C. Act of 1934 Sec. 12(g)." ME. REV. STAT. ANN. tit. 13A, § 908 (1974); TENN. CODE ANN. § 48-909(3) (Supp. 1975).

In 17 C.F.R. § 230.153(b) (1975), the term "national securities exchange" is defined as a securities exchange registered as a national securities exchange under the Securities Exchange Act of 1934. Any exchange may be registered with the Securities and Exchange Commission as a national securities exchange by filing a registration statement with the Commissioner. 15 U.S.C. § 78f(a) (1970). As of June 30, 1974, there were 13 exchanges so registered: American Stock Exchange, Inc.; Board of Trade of the City of Chicago; Boston Stock Exchange; Chicago Board Options Exchange, Inc.; Cincinnati Stock Exchange; Detroit Stock Exchange; Midwest Stock Exchange, Inc.; National Stock Exchange; New York Stock Exchange, Inc.; Pacific Stock Exchange, Inc.; PBW Stock Exchange, Inc.; Intermountain Stock Exchange; Spokane Stock Exchange. 40 SEC ANN. REP. 47 (1974).

Instead of using "national securities exchange," Pennsylvania and Utah specify the New York Stock Exchange or the American Stock Exchange, PA. STAT. ANN. tit. 15, § 1515(L) (Supp. 1975); UTAH CODE ANN. § 16-10-75 (1973). Rhode Island

exception⁶ must either accede to the corporate action with which they disagree or sell their shares on the market.

requires only a "full, free, fair and active market." R.I. GEN. LAWS ANN. § 7-1.1-73 (1970).

A majority of these 20 jurisdictions also invoke the exception when the shares are held by at least 2000 shareholders. *See, e.g.*, DEL. CODE ANN. tit. 8, § 262(k) (1975); FLA. STAT. ANN. § 608-22 (Supp. 1973); KAN. STAT. ANN. § 17-6712(k) (1974); LA. REV. STAT. ANN. § 12:131(3) (West 1969); MICH. COMP. LAWS ANN. § 450.1762(1) (1973); R.I. GEN. LAWS ANN. § 7-1.1-73 (1970); VA. CODE ANN. § 13.1-75(i) (Supp. 1975); *see also* text at notes 38, 39 *infra*. Pennsylvania uses 2500 instead of 2000. PA. STAT. ANN. tit. 15, § 1515(L) (Supp. 1975). New Jersey lowered its shareholder requirement to 1000 in 1972. N.J. STAT. ANN. tit. 14A:11-1. (1)-(4) (Supp. 1975). The minimum shareholder requirement is designed to apply the exception to certain stocks traded over the counter. The over-the-counter market includes all publicly traded securities except those traded on organized exchanges. Stocks are traded there if they do not qualify for national exchange listing, are closely held or unseasoned, have a high price, or if there is little speculative interest in the shares. *See* F. AMLING, INVESTMENTS: AN INTRODUCTION TO ANALYSIS AND MANAGEMENT 226 (1974). It is estimated that the shares of over 20,000 corporations are traded over the counter. J. LORIE & M. HAMILTON, THE STOCK MARKET: THEORIES AND EVIDENCE 4 (1973). In the second quarter of 1975, over-the-counter trading in common stocks accounted for 9.4 per cent of all U.S. common stock trading activity. SEC, 34 STAT. BULL. 847 (Oct. 1975).

The most recent adoption of a stock-market exception statute is in California's General Corporation Law, which becomes effective January 1, 1977. It will apply the exception to stocks listed on a national securities exchange certified by the Commissioner of Corporations and to stocks on the list of over-the-counter margin stocks issued by the Board of Governors of the Federal Reserve System. However, the exception will not apply to any stock if there is any restriction imposed on its transfer by the corporation or by law or regulation. Also, if the owners of five per cent or more of the outstanding shares dissent, the exception will not apply. CAL. CORP. LAW. ch. 682, § 1300(b)(1) (Deering's Cal. Codes, Advance Leg. Serv., 1975 Spec. pamphlet).

6. There is an important distinction between an appraisal statute that requires the payment of "market value," and an appraisal statute that includes the stock market exception, sometimes referred to as the "market out" or "cash out" provision. If an appraisal statute demands the payment of market value, appraisers calculate a "market value" which may or may not be the market price. The stock-market exception eliminates appraisal altogether, and requires the dissenting shareholder either to accede to the majority's action or to sell his interest in the enterprise on the market. If the dissenter chooses to sell, the sole criterion of his shares' value becomes the prevailing market price.

Another important consideration is that the stock-market exception operates only where the right to dissent has been granted. Since the stock market exception takes away statutory rights, the provision's impact is less severe in a state that has granted fewer dissenters' rights. For example, if a state allows appraisal only in cases of proposed corporate mergers, then the stock market exception is actually the rule for all other types of fundamental changes requiring shareholder approval. The exception also exists in de facto form when the state denies shareholders the right to approve a particular proposed action. For example, proposed amendments to section 73 of the MBCA provide that shareholder approval not be required if a plan of merger or consolidation does not increase the number of outstanding shares of the corporation by more than 20 per cent. By deleting the requirement for a shareholder vote, the proposed amendment eliminates the right to demand payment for the shares. *See* SUBCOMMITTEE ON DISSENTERS' RIGHTS, COMMITTEE ON CORPORATE LAWS, SECTION OF CORPORATION, BANKING, AND BUSINESS LAW (hereinafter SUBCOMMITTEE), PRELIMINARY DRAFTS OF AMENDMENTS TO SECTIONS 79, 80 and 81 OF THE MODEL BUS. CORP. ACT 3 (Feb. 11, 1976).

Legislation has attempted to balance fairly the interests of the dissenting shareholder against the corporation's need to reorganize in response to changing economic conditions. The bull market that lasted through 1972 persuaded many drafters of corporate statutes that a dissenting shareholder's interests were adequately protected if he could sell his shares on the market. Accordingly, they promulgated the stock market exception to limit the situations in which the appraisal remedy might inhibit needed corporate flexibility. Low stock prices during 1973 and 1974⁷ have generated a need to reassess this balancing of interests and to reconsider the desirability of the stock market exception.⁸

This Note engages in such a reassessment. It contends, first, that appraisal has not been an unreasonable burden on corporations and that adjustments in the appraisal procedure can eliminate remaining inequities. Next, it asserts that the stock market exception inadequately protects the dissenting shareholder, since a market might, for a variety of reasons, price a shareholder's stock at less than its intrinsic value. Finally, this Note concludes that an appraisal procedure with modifications, and not the stock market exception, reflects the appropriate balance of corporate and shareholder interests.

I. THE ORIGIN OF THE STOCK MARKET EXCEPTION

Corporations in the early nineteenth century were small, closely held enterprises that resembled modern ordinary partnerships.⁹ The shareholder had a personal interest in his investment and generally played a superintending role to protect it.¹⁰ Courts during this period fiercely protected property rights in situations where the possession and accumulation of property was deemed conducive to in-

7. After hitting a high of 1051.71 on January 11, 1973, the Dow Jones Industrial Average declined by more than one third, falling to 658.790 on January 10, 1975. The Value Line composite index, which is more indicative of how the average investor fared, was diminished by more than half in the same period. The average issue on the New York Stock Exchange fell 46 per cent; the average issue on the American Stock Exchange fell 57 per cent. Two thirds of the 15 best performing stock groups on the Standard and Poor's 500 Index were lower in value in 1975 than in 1973. *BUS. WEEK*, Jan. 27, 1975, at 50-51.

8. The MBCA version of the stock market exception rule, 2 ABA-ALI MODEL BUS. CORP. ACT § 80 (1969), is currently being reevaluated by a panel on dissenters' rights of the Committee on Corporate Laws. *See generally* SUBCOMMITTEE, PRELIMINARY DRAFTS OF AMENDMENTS TO MBCA §§ 73, 80, 81 (Nov. 17, 1975). Proposed amendments to section 80 would also provide the right to dissent for additional categories of corporation actions. *See* COMMITTEE ON CORPORATE LAWS OF THE ABA (Practice Handbook 1974) (any plan of exchange); SUBCOMMITTEE, *supra* note 6, at 4; (amendments to articles of incorporation that materially and adversely affect rights of dissenting shareholder).

9. Levy, *Rights of Dissenting Shareholders to Appraisal and Payment*, 15 CORNELL L.Q. 420 (1930).

10. *Cf.* J. HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970*, at 86 (1970).

creased economic development.¹¹ Accordingly, they viewed the relationship between the shareholder and the corporation as a strong one and granted shareholder interests the status of vested property rights.¹² Because of the danger that a majority shareholder might act to reduce the value of a minority shareholder's vested interest or to render that interest worthless, unanimity of all shareholders was required to effect a fundamental corporate action.¹³

As long as corporations remained small and closely held, the rule of unanimity was only a minor limitation on corporate flexibility. The tremendous expansion of commerce in the last half of the nineteenth century, however, created a need for larger and more complex corporate entities.¹⁴ Yet the rule of unanimity impeded corporate reorganization necessary for economic growth by permitting any shareholder to enjoin a corporate action with which he did not agree.¹⁵ Growing corporations began to circumvent the rule by settling with dissenters through payments that far outweighed the value of the shareholders' interests.¹⁶ Recognizing the need for corporate flexibility, courts proceeded to temper the rule of unanimity by allowing dissenters to recover the value of their shares in cash from the corporation in situations where the costs of upsetting the transaction would be excessive.¹⁷ Thus, courts gradually retreated from the rule of una-

11. See Horwitz, *The Transformation in the Conception of Property in American Law, 1780-1860*, 40 U. CHI. L. REV. 248, 290 (1973).

12. Cf. *City of Evansville v. Hall*, 14 Ind. 27 (1860); *Graydon's Exrs. v. Graydon*, 23 N.J. Eq. (8 Green) 229, 233 (1872); *Arnold v. Ruggles*, 1 R.I. 165, 174 (1837); *Moore v. Schuppert*, 22 W. Va. 282, 291 (1883).

13. Levy, *supra* note 9, at 420.

14. See Hurst, *supra* note 10, at 72.

15. Levy, *supra* note 9, at 420; Pierce, *Right of Dissenting Shareholder to Appraisal*, in CURRENT TRENDS IN STATE LEGISLATION 145 (1952).

16. See *Johnson v. Baldwin*, 221 S.C. 141, 154, 69 S.E.2d 585, 591 (1952); Lattin, *Remedies of Dissenting Stockholders Under Appraisal Statutes*, 45 HARV. L. REV. 233, 236-37 (1931).

17. An early example of this approach is *Lauman v. Lebanon Valley R.R.*, 30 Pa. 42 (1858) where minority shareholders sought an injunction against the merger of two railroads. The economic boom of the late nineteenth century began in railroad-ing, and, predictably, pressures for increased corporate flexibility appeared initially in that industry. The *Lauman* court responded sympathetically to this interest and held that the dissenters could not prevent the merger if the corporation repurchased the stock when its value was subsequently ascertained. Thus, the court embraced the logic of the appraisal remedy and struck a balance that not only allowed the corporate transaction to proceed but also protected the dissenters, who could not be forced into the corporation and would receive a payment for the value of their stock.

To facilitate corporate reorganization courts occasionally tempered the rule of unanimity by allowing the dissenters to recover the value of their shares, on the theory that the property interest represented by the stock had been converted by the corporate majority. Lattin, *supra* note 16, at 236-37. This judicial approach was applied, for example, where the dissenter had delayed seeking injunctive relief, the granting of which would now impose a particularly severe burden on the corporation. See *Garrett v. Reid-Cashion Land & Cattle Co.*, 34 Ariz. 245, 270 P. 1044 (1928), cited in Lattin, *supra* note 16, at 234 n.1. It was also applied where intervening

nimity as the guarantor of shareholder interests, but articulated the principle that a shareholder could not be compelled to accept what was, in effect, an investment in a completely different corporation.

Legislatures of the early twentieth century, sympathetic to the furtherance of corporate interests impaired by obsolete common-law rules, joined in the attack on the rule of unanimity by enacting statutes that allowed corporations to effect changes by a simple majority vote.¹⁸ These statutory provisions were soon thought, however, to impinge too greatly on the interests of the shareholder.¹⁹ Legislatures responded by developing the appraisal concept, which granted dissenters the right to receive the cash value of their stock as compensation for the elimination of the common-law rule that a single shareholder could block a corporate action.²⁰ The early appraisal statutes, therefore, reflected a balancing of the need to facilitate corporate structural changes required by changing economic conditions against the need to protect the investments of dissenting shareholders.²¹

This scheme remained substantially intact until the mid-1960s when the appraisal remedy as applied to shareholders whose stock was widely held came under rigorous attack by several commentators.²²

purchasers came innocently to possess a share of the corporate enterprise. See *Tanner v. Lindell Ry.*, 180 Mo. 1, 79 S.W. 155 (1904), discussed in Lattin, *supra* note 16, at 236.

18. See, e.g., S.D. LAWS, ch. 118, S.B. 41 (1909) (three-fourths majority), as amended S.D. COMP. LAWS ANN. § 47-4-13 (1967).

19. Where the majority-rule statutes did not specify remedies for nonconsenting shareholders, courts construed them as not abrogating the court-created "right" of the dissenter to demand the value of his shares. See, e.g., *Kremer v. Public Drug Co.*, 41 S.D. 365, 374, 170 N.W. 571, 573-74 (1919).

20. See *Voeller v. Neilston Co.*, 311 U.S. 531, 535 n.6 (1941); *Francis I. du Pont & Co. v. Universal City Studios, Inc.*, 343 A.2d 629, 634 (Del. Ch. 1975); *In re Timmis*, 200 N.Y. 177, 181, 93 N.E. 522, 523-24 (1910); *Winfree v. Riverside Cotton Mills*, 113 Va. 717, 724, 75 S.E. 309, 312 (1912). *Contra*, Folk, *Revisiting the North Carolina Corporation Law: The Robinson Treatise Reviewed and the Statute Reconsidered*, 43 N.C. L. REV. 768, 860 n.384 (1965). Folk believes that appraisal is a transitional device that has allowed the corporation to take action without complying with the common-law rule of unanimity, and that since the rule of unanimity is unlikely to be applied today, there is no reason for appraisal. This differs from the court's view in *Voeller* that appraisal was developed after majority-rule statutes were adopted in response to the victimization of minorities and a subordination of their interests caused by the absence of such a remedy. 311 U.S. at 535.

Because the first majority rule statutes affected only railroads, the first appraisal statutes were limited to that industry. As economic pressures were felt in other industries and as majority-rule statutes were broadened, the appraisal right was also extended. Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 246-47 n.38 (1962).

21. See *Salt Dome Oil Corp. v. Schenck*, 28 Del. Ch. 433, 442, 41 A.2d 583, 587 (1945).

22. See, e.g., Manning, *supra* note 20; Moscow, *Aspects of Shareholders' Rights*, 18 WAYNE L. REV. 1003, 1023 n.103 (1972) (argues appraisal does not protect anyone who needs protection). But see Schulman, *Shareholder Rights in Acquisition*

The arguments advanced by the critics suggested, in essence, that appraisal in the widely held corporation seriously impaired corporate interests and did not benefit shareholder interests sufficiently to justify its cost.

The first contention of the proponents of the stock market exception was that those who purchased widely held securities had no real interest in the nature of the enterprises in which they were investing. Accordingly, they asserted, the principle from which the appraisal right was derived—that a shareholder should not be compelled to accept an investment in a completely different corporation—no longer protected any legitimate interest and thus failed to justify retention of the appraisal remedy in the context of widely held corporations. In the words of one commentator:

[I]n substantially every case other than [those] related to control, the owner of shares of a company listed on a national securities exchange regards himself as an investor in those securities, rather than as a part of the corporate enterprise. The investor's objective is not to promote the income of the corporation but to enhance his distributive share, not to increase the corporate assets but to enhance the value of his securities. Since the measurement of these objectives is provided by the exchanges . . . dissent and appraisal no longer [were] required.²³

Transactions: A Dissent, 18 WAYNE L. REV. 1041, 1067 (1972) ("[W]hen the transaction is unfair to one group, their ability to leave the venture is no more a justification for the elimination of their appraisal rights than it would be a justification for eliminating their right to seek judicial review of such transactions"). The arguments advanced by the critics in the early 1960's are sometimes uncritically accepted 15 years later. See Note, *Corporate Freeze-Outs Effected by Merger: The Search for a Rule*, 37 U. PITT. L. REV. 115, 119 (1975).

23. Scott, *Changes in the Model Business Corporation Act*, 24 BUS. LAW. 291, 303 (1968). See also Kerr & Letts, *Appraisal Procedures for Dissenting Delaware Stockholders*, 20 BUS. LAW. 1083, 1084 (1965). Superficially, this statement appears reasonable, since the large corporate enterprise with thousands of shareholders is obviously considerably different than the early corporation where a few shareholders owned the corporation and controlled its actions. The new, larger corporation which emerged in the late nineteenth century did possess a small, powerful leadership which was able to make decisions unaffected by the desires of most shareholders. 2 J. DAVIS, *CORPORATIONS* 272-74 (1905, 1971 reprint); HURST, *supra* note 10, at 85-86. In addition to the advent of elite control, Professor Hurst has observed a shift in the pattern of investment that reinforced the trend away from shareholder superintendence of corporate decisions. In the late nineteenth century, investors in corporate shares were businessmen who, seeking to place surplus earnings in limited-commitment investments, "had an entrepreneur's concern with the profit possibilities and records of the companies into which they put money." In contrast, after 1900, investors were workers and professionals who were concerned with assured incomes and long-term appreciation. These investors were not entrepreneurial-minded and did not take an interest in or closely scrutinize corporation operations. HURST, *supra* note 10, at 86. Finally, it has been argued that the growth of institutional investment demonstrates that the bulk of post-1900 stockholders are increasingly investment minded and not enterprise oriented. It is asserted that institutions rarely vote for new management or vote against corporate policies, and instead sell out to express dissatisfaction with management. The institutions are thought to behave as trustees, not risking the assets over which they have charge by making structural decisions.

Second, the critics argued that appraisal obstructed the efforts of management to plan corporate changes. If the number of dissenters became large, cash payments to dissenters could sufficiently drain the corporation's working capital to thwart the entire reorganization.²⁴ Moreover, the argument continued, a cash-flow shortage resulting from paying dissenters could cause insecurity among existing creditors of the corporation and could frustrate post-reorganization attempts to acquire new credit.²⁵ Because the number of dissenters could not be ascertained in advance of any contemplated reorganization, the mere threat of financial dislocation from a substantial dissent might discourage management from suggesting changes which, if actually carried out, would have invoked only a nonburdensome response from shareholders.²⁶

Third, the critics attempted to derogate the appraisal remedy by challenging the assumption that the availability of appraisal avoided the enjoining of corporate actions.²⁷ A principal basis for this challenge was the observation that judicial intervention in Delaware was no more frequent in cases where appraisal was denied than where appraisal was allowed.²⁸

The fourth assertion of the critics was that appraisal afforded shareholders no benefit that sale on the market could not provide. The appraisal remedy, in their view, merely created a special market where the dissenting shareholder could be bought out at a judicially determined price. Accordingly, they concluded that the existence of a market where the dissenter's stock was widely traded obviated the need for valuation by a court.²⁹

Finally, the critics noted that appraisal, like any court proceeding,

HURST, *supra* note 10, at 87-88. As the size of the institutions' share of stock holdings has increased (for example, on the NYSE, institutional holdings have increased from 14.5 per cent of total market value in 1949 to an estimated 33.0 per cent in 1974, NYSE 1975 FACT BOOK 50), the passive role attributed to institutions has strengthened the contention that shareholders are not interested in the actual operation of the corporation.

24. Manning, *supra* note 20, at 234. In *Farris v. Glen Alden Corp.*, 393 Pa. 427, 143 A.2d 25 (1958), an action by shareholders to enjoin a corporate reorganization, counsel for defendants claimed that if the corporation was required to pay the dissenting shareholders the appraisal value of their shares, the resultant drain of cash would prevent the corporation from carrying out the agreement. 393 Pa. at 431 n.5, 143 A.2d at 28 n.5. See Note, *The Right of Shareholders Dissenting from Corporate Combinations To Demand Cash Payment for Their Shares*, 72 HARV. L. REV. 1132 (1959); see also A. CONARD, R. KNAUSS & S. SIEGEL, ENTERPRISE ORGANIZATION 1137 (1972).

25. Manning, *supra* note 20, at 234.

26. *Id.* at 235.

27. Cf. SUBCOMMITTEE, PRELIMINARY DRAFTS OF AMENDMENTS TO MODEL BUS. CORP. ACT §§ 73, 80, 81 AFFECTING DISSENTERS' RIGHTS 2 (Oct. 22, 1975).

28. See E. FOLK, THE DELAWARE GENERAL CORPORATION ACT 395-96 (1972); Moscow, *supra* note 22, at 1028.

29. E. FOLK, *supra* note 28, at 38.

was expensive for the participants.³⁰ Imposition of costs on the dissenter, they urged, at best reduced his recovery below the full value of his shares³¹ and, in the extreme, totally eliminated the efficacy of the remedy for him unless he owned a large number of shares and the market price—intrinsic value differential of the shares was significant.³² On the other hand, they noted, the imposition of costs on the corporation increased the harassment potential of the appraisal right and thus could subject the corporation to vexatious suits.³³

The Delaware Revision Committee, when drafting a new general corporation law, found the arguments of these critics persuasive and proposed abolishing the appraisal right to shareholders of publicly held corporations. The legislature agreed and, in 1967, Delaware became the first state to enact the stock market exception.³⁴ The Committee on Corporate Laws of the American Bar Association decided two years later to add the provision to the Model Business Corporation Act.³⁵ Many of the leading states for incorporation, with the noteworthy exception of New York, soon followed these two initiatives with the result that, now, over two thirds of all corpora-

30. Attorneys' fees, expert witness fees, court time, and the freezing of the dissenter's investment for the duration of the proceeding are costs that must be assumed by the parties and by the judicial system. See generally Note, *The Dissenting Shareholder's Appraisal Statute: Influence of Cost and Interest Provisions upon the Efficacy of the Remedy*, 50 B.U. L. REV. 57 (1970). Although interest provisions in many states mitigate the effects of the stock being frozen, see, e.g., DEL. CODE ANN. tit. 8, § 262(h) (1975); ME. REV. STAT. ANN. tit. 13-A, § 909.9.G (1974), the dissenter is denied the opportunity to take advantage of alternative investments for the period of the proceedings.

31. Pierce, *supra* note 15, at 155.

32. Note, *supra* note 30, at 60.

33. Note, *supra* note 30, at 64. See *In re Marcus*, 273 App. Div. 725, 79 N.Y.S.2d 76 (1948). The New York legislature revised the state's corporation law to avoid this problem in 1950. Note, *Corporation Law—Dissenting Stockholder's Right of Appraisal—Determination of Value*, 28 N.Y.U. L. REV. 1021, 1030 (1953).

34. New York had passed a comprehensive revision of its corporation law in 1963, N.Y. BUS. CORP. LAW (McKinney 1963), and Delaware was deeply concerned about maintaining its leading role as a state of incorporation, W. CARY, CASES AND MATERIALS ON CORPORATIONS 12-13 (4th ed. unabr. 1969). As a result, Delaware was most interested in providing an attractive legal climate that would maximize the flexibility of management in its control of corporations and minimize interference from state regulation. E. FOLK, *supra* note 28, at xxii. Passing a statute that would minimize dissenter's involvement with corporate affairs, as long as it was not blatantly unfair to the dissenter, was consistent with this overriding philosophy.

35. 2 ALI-ABA MODEL BUS. CORP. ACT ANN. § 80 (1969). Since the MBCA "competes" with the Delaware statute (which is thought to be the most desirable law for any substantial interstate company, W. CARY, *supra* note 34, at 9-10) in that those states that follow the MBCA are vying with Delaware for incorporations, it is likely that the Committee was concerned about lacking a provision favorable to corporations that Delaware possessed. Since the stock-market exception presumably makes reorganization easier by eliminating appraisal, the Committee probably thought the failure to include it in the MBCA would attract corporations to Delaware instead of to those states following the MBCA. See SUBCOMMITTEE, REPORT OF PROGRESS AND REQUEST FOR INSTRUCTIONS 2 (Sept. 8, 1975).

tions listed on the New York Stock Exchange (NYSE) are incorporated in states that have adopted the exception.³⁶

II. THE ARGUMENTS RECONSIDERED

Of the five arguments in favor of the stock market exception, the contention that a shareholder could receive the fair value of his stock by selling on the market was certainly the most persuasive to legislatures during the period of strong market performance of the late 1960s through 1972. However, it has been called into question by fluctuations in market prices since 1972. Before reexamining the contention and the related criticism that costs of appraisal outweigh any benefits, this Note will briefly reconsider the other arguments that have been made by proponents of the exception.

The critics' first argument, that a shareholder in a widely held corporation views his interest in the corporation as an investment rather than as a stake in ownership, oversimplifies the purpose of appraisal and the role of the stockholder. Admittedly, the historical reason for the appraisal remedy was to preserve the shareholder's right not to be compelled to join an entirely different enterprise. Its practical effect today, however, is to preserve the value and liquidity of the shareholder's investment, and it is in these terms, presumably, that most shareholders now view the remedy. Thus, this argument of

36. Of the 1,542 domestic corporations listed on the NYSE as of March 31, 1976, 70.1 per cent were incorporated in states that either have the stock-market exception or will put the exception into effect shortly:

STATES	NUMBER OF LISTED CORPORATIONS
Delaware	655
California	83
Pennsylvania	63
New Jersey	58
Maryland	54
Virginia	34
Florida	25
Indiana	22
Wisconsin	21
Michigan	20
Maine	13
Georgia	11
Kansas	10
Iowa	8
Arizona	5
Tennessee	4
Utah	4
Rhode Island	3
Louisiana	2
Nebraska	2
	<hr/>
	1097 (70.1 per cent of 1,542)

See 1 CCH NYSE GUIDE 701 (1976). Of the eight leading states for incorporations, which together account for nearly three quarters of all incorporations, only three—Massachusetts, New York, and Ohio—do not have the stock market exception.

the critics attacks only the historical basis of the appraisal remedy and not the primary reason for its continued existence.³⁷

Moreover, the critics are not even persuasive in their contention that shareholders in listed corporations have little interest in the nature of the enterprises in which they invest.³⁸ Many corporations that fit within the stock market exception, particularly those listed on regional exchanges and those that barely satisfy the 2000-shareholder statutory minimum, have investors who hold large blocks of stock. Such a shareholder often has legitimate expectations of participating in the making of corporate decisions³⁹ and may well be dismayed at the prospect of having the corporation merge into a much larger entity in which he would play only an insignificant role. Furthermore, even if a shareholder is interested solely in maximizing the value of his shares, he still will be deeply concerned about the corporation's current and prospective earnings and may thus take an interest in decisions of the corporation affecting those earnings. The small shareholder, to be sure, may view his shares as a mere investment. But it is not the small shareholder who is likely to exercise his appraisal right; rather, it is the larger shareholder who might have played an active role in the governance of the corporation.

A further indication that shareholders in widely held corporations have enterprise interests is the incipient breakdown in the predisposition of institutional shareholders to vote in favor of existing management.⁴⁰ While institutions may not question minor management

37. The argument that appraisal is not intended to protect enterprise-oriented stockholders is structured as follows: the only way really to protect the enterprise interest of the shareholder in corporation *X* is to preserve his investment in corporation *X*, and hence preserve corporation *X*. The abolition of the rule against unanimity reflected the judgment that protection of this interest was not worth preventing the contemplated change in corporation *X*. Accordingly, the shareholder must accede or get the fair value of his share. Appraisal gives the shareholder an alternative to becoming part of a changed corporation *X*, by giving him the value of his share in the old corporation *X*. Thus, whether the investor has an interest in that corporation *X* is irrelevant. The function of appraisal is to give the shareholder the fair value of his interest in corporation *X* rather than to preserve his interest in corporation *X* by allowing him to obstruct the proceeding.

38. See generally J. DAVIS, *supra* note 23, at 273-74: "The purchaser of stock considers that he is acquiring an interest in an enterprise, not so much that he is assuming common relations with the numerous other stockholders . . . the stockholder looks upon himself rather as a participant in the corporate enterprise than as an associate of his fellow stockholders."

39. See *Leighton v. American Tel. & Tel. Co.*, 397 F. Supp. 133, 138 (S.D.N.Y. 1975); Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 33-37 (1969). Studies have attempted to measure the degree of shareholder control of corporations. See, e.g., Palmer, *The Separation of Ownership from Control in Large U.S. Industrial Corporations*, 12 Q. REV. ECON. & BUS. 55, 61 (Autumn 1972) (frequency of owner control of large corporations has declined from 1929-1961).

40. Eisenberg, *supra* note 39, at 50-53.

decisions affecting the enterprise,⁴¹ they show a general tendency to make independent judgments on those questions that give rise to the exercise of dissenters' rights.⁴² Finally, many of the companies listed on securities exchanges do not have large numbers of atomistically dispersed shareholders. Many exchanges have low requirements for the number of shareholders a company must have in order to be listed and traded.⁴³ Even if large companies with many shareholders have low stockholder involvement, it is not unreasonable to expect that investors in companies on the smaller exchanges may be much more enterprise oriented.

The critics' argument that the appraisal remedy inhibits corporate decision-making is difficult to support, and, in so far as there is a problem, it can easily be remedied.⁴⁴ The extent to which corporations are deterred from making structural decisions by the prospect of having to buy out dissenters is, for the most part, unquantifiable. It is not surprising then that proponents of the stock market exception themselves offered no evidence to support their contention.⁴⁵ In fact,

41. See Solomon, *Institutional Investors: Stock Market Impact and Corporate Control*, 42 GEO. WASH. L. REV. 761, 785-86 (1974). Solomon suggests that institutions have a *general* pro-management policy. Some have a *de facto* policy of voting with management, while others will sell their shareholdings rather than vote against management.

42. As Solomon has observed:

Certain issues, generally those affecting the value of a given security, may arouse . . . increased opposition to management. These items include the abolition of preemptive rights, modifications in corporate capital, and changes in the percentage of shareholder approval required for a merger or sale of assets. Transfers of corporate control, whether by way of merger or tender offer, also lead to greater scrutiny of corporate management. The acceptability of the terms of a merger or a tender offer to significant institutional investors may affect the outcome of contests for corporate control.

Solomon, *supra* note 41, at 786. See also SEC, INSTITUTIONAL INVESTOR STUDY REPORT (hereinafter IIS REPORT) pt. 5, at 2749-2849 (1971).

43. See 2 SEC, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS 815-16 (1963) (hereinafter 1963 SEC STUDY).

44. Early in the process of deciding whether to reorganize, corporations should be afforded the opportunity to ascertain how many dissenters must be paid. Certainty as to the number of shareholders dissenting may be necessary in order to determine whether the payment to the dissenters would decrease the corporate assets to the extent that a reorganization would be disqualified from tax-free treatment. See, e.g., INT. REV. CODE OF 1954, §§ 368(a)(1)(C), 368(a)(2)(B)(iii). Cf. Treas. Reg. § 1.368-1(b) (1955) (requirement of continuity of proprietary interest). However, the certainty required can be obtained by establishing an appraisal procedure that requires dissenters to give notice of the number of shares involved in a dissent at an early point in the reorganization attempt. Thus, abolition of appraisal by means of the stock-market exception is not necessary to eliminate uncertainty. A remedy for the remaining problem of whether the corporation has sufficient cash to pay the dissenters is proposed in text following note 49 *infra*.

45. Manning, *supra* note 20, provided no support for the argument that corporate reorganizations are deterred. While the corporate defendant in *Farris v. Glen Alden Corp.*, 393 Pa. at 431 n.5, 143 A.2d at 28 n.5 did allege a deterrence, *supra* note 24, there was no factual support produced. Eisenberg, *supra* note 39, similarly provides no support for the contention that the prospect of a dissent does not deter corporate change, other than his observation that corporate reorganizations are occurring with

the apparent frequency of corporate structural changes notwithstanding appraisal has led one observer to conclude that (1) uncertainty as to the number of dissenters rarely upsets corporate plans,⁴⁶ (2) corporations forced to buy out dissenters generally have sufficient cash reserves,⁴⁷ and (3) creditors generally seek to retain their business with new enterprises despite the cash drainage caused by dissenters.⁴⁸ Even so, it seems logical that dissenting shareholders in some situations might hold too many shares for the corporation feasibly to repurchase. The undesirability of this prospect is not beyond dispute, since it can be argued that the power of dissenters serves as a beneficial counterbalance to management discretion.⁴⁹ In any event, the obstruction of a proposed corporate action by a large dissent can be easily remedied. Current appraisal statutes require the corporation to pay in cash the full appraised value of the dissenters' shares. This procedure could be amended to give the corporation the power to demand that the dissenters sell their shares on the market, with the corporation paying only the difference between the appraised value of the shares and the market price realized on the sale. Such an amendment would produce several benefits. The smaller cash payment would reduce any cash-flow problems faced by the corporation and thereby lessen the inhibiting effect of the appraisal right on managerial decision-making. Moreover, since a dissenter might sell his shares immediately, his entire investment would not be tied up for the duration of the appraisal proceeding. Finally, and perhaps most importantly, the amended procedure would reduce the leverage of dissenting shareholders and, consequently, the incidence of vexatious suits.

The critics argument that appraisal does not protect corporations from injunctions⁵⁰ is refuted by recent experience with the stock market exception. It is not infrequent that a court notes the existence of appraisal as a ground for denying a minority shareholder's request

greater frequency. Of course, it would be almost impossible to prove that appraisal has had no influence on corporate planning.

46. Eisenberg, *supra* note 39, at 74.

47. *Id.* at 73.

48. *Id.* at 73-74.

49. *Id.* at 84-86, quoting Folk, *De Facto Mergers in Delaware: Haritan v. Arco Electronics, Inc.*, 49 VA. L. REV. 1261, 1293 (1963):

[I]t is important to maintain some internal or external control to offset the power of the directors, unless one assumes that directors, especially when backed by a shareholder majority, should have unrestrained discretion. Appraisal rights . . . have, in the past, served as a countervailing power to force the insiders to tailor their plans to minimize the number of dissenters by getting the best deal possible. A high vote requirement (including a class vote) plays the same sort of role. When either weapon is removed, the insider lacks the real self-interest to fashion a plan acceptable to a sufficient number of shareholders.

50. In advancing this argument, the critics reject one of the reasons behind the adoption of appraisal—to prevent de facto injunctions which resulted under the rule of unanimity.

for injunctive relief.⁵¹ When a case falls within the stock market exception and the court doubts the fairness of the prevailing market price, an incentive exists to enjoin the corporate action to protect the dissenter's interest.⁵² Where minority shareholders seek an injunction on the ground that the market price is unfair, appraisal is well-suited to decide the issue without obstructing the corporate action.

In sum, the first three arguments marshalled by the critics have little force in supporting the stock market exception. The desirability of the exception, then, turns on the validity of the final two contentions: that appraisal is unnecessary because of the existence of a ready market where the stock is listed or widely traded and that the costs of appraisal outweigh its benefits. These contentions require more detailed analyses.

A. *Market Price and Intrinsic Value*

Advocates of the stock-market exception assume that the market price of a stock equals its value. The validity of this proposition, however, is the subject of much dispute.

1. *Theories of Market Action*

Students of the stock market have devised several theories to explain how the market works and what relation market price bears to value.⁵³ Graham and Dodd's security analysis theory has been the

51. See, e.g., *Grimes v. Donaldson, Lufkin & Jenrette, Inc.*, 392 F. Supp. 1393, 1404 (N.D. Fla. 1974); *Greene v. Schenley Indus., Inc.*, 281 A.2d 30, 33 (Del. Ch. 1971); *Brundage v. New Jersey Zinc Co.*, 48 N.J. 450, 470, 226 A.2d 585, 595-96 (1967); *Bove v. Community Hotel Corp.*, 105 R.I. 36, 52, 249 A.2d 89, 99-100 (1969).

52. This was the result in a recent New Jersey decision, *Berkowitz v. Power/Mate Corp.*, 135 N.J. Super. 36, 342 A.2d 566 (L. Div. 1975), where minority shareholders were granted a temporary injunction against a proposed merger. Power/Mate was a publicly held corporation whose shares were traded on the National Stock Exchange until it ceased operations on Jan. 31, 1975, and thereafter were traded over the counter. The right to dissent and obtain an appraisal was denied because the dissenters were to be paid for their shares in cash at the current market price. N.J. STAT. ANN. § 14A:11-1(1)(a) (Supp. 1975). Power/Mate had gone public in the late 1960s during the boom market, and was now repurchasing shares at low market prices, creating huge profits for the insiders. See generally Note, *Going Private*, 84 YALE L.J. 903 (1975). The court suggested that the conduct of insiders may have contributed to the decline of the stock's price, and that even if the majority would benefit from the proposed merger, the question would be whether "the price (the dissenters) are being offered for their interest in Power/Mate is a fair and reasonable one." 135 N.J. Super. at 49-50, 342 A.2d at 574. This is precisely the kind of problem for which appraisal is well suited, yet the New Jersey exception to appraisal foreclosed such a proceeding. If appraisal had been available, it is questionable whether the court would have granted the injunction since the majority's plan was unfair primarily because the market price was unfair. Appraisal could have protected the dissenter's interest by adjusting market price, and thereby allowed the corporate action to proceed.

53. Technical analysis, for example, does not deal with the relation of price and

dominant one for over forty years.⁵⁴ The security analysis theory posits that market price does not necessarily equal a share's value, and thus seeks to determine whether and to what extent the intrinsic value of a particular stock differs from its market price.⁵⁵ Intrinsic value is

value, but concludes that investment decisions should be based solely on price and volume histories, on the assumption that knowledge of the past behavior of a price will enable a prediction of the future price. The technical analyst or "chartist" attempts to predict the timing of a stock's reversal of an upward or downward trend in order to sell or buy in anticipation of a price change. The theory was developed around 1900 by Charles Dow. H. LATANE & D. TUTTLE, *SECURITY ANALYSIS AND PORTFOLIO MANAGEMENT* 269 (1970). The theory has been severely criticized for its lack of scientific method. See *id.* at 270-71; B. GRAHAM, D. DODD & S. COTTLE, *SECURITY ANALYSIS: PRINCIPLES AND TECHNIQUE* 712-16 (4th ed. 1962). Pure chartists are relatively rare. Fama, *Random Walks in Stock Market Prices*, 21 *FINAN. ANALYSTS J.* 55 (Sept.-Oct. 1965). For a more elaborate explanation of the technical analysis theory, see B. MALKIEL, *A RANDOM WALK DOWN WALL STREET* 95-135 (1973); H. LATANE & D. TUTTLE, *supra*, at 353-79; E. FOSTER, *COMMON STOCK INVESTMENT* 55-68 (1974). Since technical analysis ignores the relation of price to underlying value, it is meaningless for purposes of evaluating the assumptions behind the stock-market exception.

A second theory, psychological analysis, best explained and practiced by John Maynard Keynes, looks solely at the mass psychology of buyers and sellers in order to anticipate price changes far in advance. The approach rejects the idea that stock prices are a function of intrinsic values, because such values are allegedly too difficult to determine. It tries to second-guess the investment decisions of what is perceived to be a mass of unsophisticated investors. Although not important to the psychological analyst, implicit in the theory is the idea that price probably will not equal value since investors act irrationally. Accordingly, this approach gives no indication of what the underlying values might be. For a discussion of this approach, see B. MALKIEL, *supra*, at 22-25; H. LATANE & D. TUTTLE, *supra*, at 271-73.

54. H. LATANE & D. TUTTLE, *supra* note 53, at 264. See generally H. SAUVAIN, *INVESTMENT MANAGEMENT* 194-95 (4th ed. 1973).

55. The process employed by security analysts to value stocks varies. John Burr Williams in *THE THEORY OF INVESTMENT VALUE* (1938), advanced the theory that the true present value of a security, V_0 , is the sum of the present worth of all dividends to be paid on it, expressed as follows where D_1 is the first dividend, D_2 the second, and i is the rate at which the dividends are discounted:

$$V_0 = \frac{D_1}{(1+i)} + \frac{D_2}{(1+i)^2} + \dots + \frac{D_N}{(1+i)^N}$$

Williams believed that the amount of dividends is the true and only measure of the present value of a stock. J. LORIE & M. HAMILTON, *THE STOCK MARKET: THEORIES & EVIDENCE* 115 (1973); H. LATANE & D. TUTTLE, *supra* note 53, at 261-63.

Graham and Dodd advanced a different approach, regarding "indicated average future earning power" to be the single most important determinant of a share's present value. B. GRAHAM, D. DODD & S. COTTLE, *supra* note 53, at 28. The estimate of future earning power is made by averaging past data for sales volume, prices received, and operating margin, and then projecting future sales based on estimates of change in volume and price level over the previous bases. These estimates are based on such factors as general economic forecasts, projected Gross National Product, and conditions in the company and industry in question. B. GRAHAM, *THE INTELLIGENT INVESTOR* 152 (1973). This forecast is in turn adjusted by an appropriate multiplier that allows the infusion of a number of less definite factors into the value formula, such as the general long-term prospects of the company, quality of management, financial strength, capital structure, the dividend record, and the current dividend rate. *Id.* at 154-58. See also J. LORIE & M. HAMILTON, *supra*, at 122-24. The earnings and dividends hypotheses are virtually

ascertained by analyzing the facts and circumstances surrounding the corporation in question, including its assets, earnings, dividends, and future prospects, and the quality of its management.

According to the proponents of security analysis, there are several reasons why intrinsic value may vary from market price. First, investors may believe inaccurate information about a stock's value, or misinterpret accurate information. Second, information about corporations does not spread instantaneously among market participants. Consequently, the market price of a stock, unlike its intrinsic value, does not fully reflect all available information at any particular point in time.⁵⁶ Accordingly, the security analyst who is first to gather information about a corporation can take advantage of discrepancies between price and value. Third, the cost of buying and selling stock deters market participation when the difference between price and value is less than the transaction cost.⁵⁷ Fourth, the decision whether to buy or sell a particular stock is often influenced by tax policies unrelated to the underlying value of the stock.⁵⁸ Fifth, relatively few investors, even among professionals, have considerable expertise and, indeed, many are irrational.⁵⁹ Finally, many investors decide whether to invest in small, relatively unknown corporations on the basis of incomplete or inaccurate information.⁶⁰

The behavior of stock market prices at times seems to support the view that market price can diverge from intrinsic value.⁶¹ Market

identical, since earnings, when defined correctly by accounting for earnings used internally as well as for apparent economic earnings, have the same present value as dividends. J. LORIE & M. HAMILTON, *supra*, at 121. See also S. BOLTON, *SECURITY ANALYSIS AND PORTFOLIO MANAGEMENT* 29-45 (1972).

The techniques of security analysis have been modified and developed to high levels of complexity and sophistication. The techniques are explained at great length in many sources. See, e.g., S. BOLTON, *supra*; B. GRAHAM, D. DODD & S. COTTLE, *supra* note 67; E. FOSTER, *supra* note 53; B. GRAHAM, *supra*; C. HUBBARD & C. HAWKINS, *THEORY OF VALUATION* 150-65 (1969); H. LATANE & D. TUTTLE, *supra*; J. LORIE & M. HAMILTON, *supra* at 113-227.

56. See E. FOSTER, *supra* note 53, at 73; H. SAUVAIN, *supra* note 54, at 167-68; W. BAUMOL, *THE STOCK MARKET AND ECONOMIC EFFICIENCY* 44-45 (1965). Quick diffusion of information through the market implies that the investing public may act before making an adequate evaluation of the information in their attempt to profit on the early part of a price trend. This could exaggerate price swings, thereby placing an unrealistic value on the securities involved. S. ROBBINS, *THE SECURITIES MARKETS* 57 (1966).

57. H. SAUVAIN, *supra* note 54, at 166.

58. *Id.* The effect of taxes on rates of return is significant. One study found that the terminal wealth of a tax-exempt investor in 1965 who had made equal investments in each common stock listed in 1926 would have been 2.26 times as great as that of an investor making the identical investments who was in the tax category corresponding to a taxable income of 50,000 dollars in 1960. J. LORIE & M. HAMILTON, *supra* note 55, at 30-31.

59. E. FOSTER, *supra* note 53, at 73; H. SAUVAIN, *supra* note 54, at 168.

60. E. FOSTER, *supra* note 53, at 73.

61. The Council of the Stock Exchange, London has stated quite clearly that quotations on that exchange should not be used for valuation purposes:

prices are often based on speculative optimism that has no basis in the economic position of the companies involved.⁶² "Growth stocks," for example, are often priced far out of proportion to the earnings strength of the companies.⁶³ At the opposite extreme, the market often grossly undervalues less glamorous corporations with high earnings potential.⁶⁴ Moreover, wide fluctuations occur in market price that presumably are not matched by simultaneous fluctuations in the

We desire to state authoritatively that Stock Exchange quotations are not related directly to the value of a company's assets, or to the amount of its profits, and consequently these quotations, no matter what date may be chosen for reference, cannot form a fair and equitable, or rational basis for compensation.

. . . [Price is determined by] the actions and opinions of private and institutional investors all over the country and, indeed, the world. The actions and opinions are the result of hope, fear, guesswork, intelligent or otherwise, good or bad investment policy, and many other considerations. The quotations that result definitely do not represent a valuation of a company by reference to its assets and its earning potential.

Cited in T. BAYNES, *SHARE VALUATIONS* 22 (1973). However, the London and American markets may be so different that any analogy of the inaccuracy of price quotations on the London exchange to the American exchanges is risky. *See* 1963 SEC STUDY, *supra* note 43, at 18-20.

62. W. BAUMOL, *supra* note 56, at 39. B. MALKIEL, *supra* note 53, at 47; G. MCCARTHY & R. HEALY, *VALUING A COMPANY: PRACTICES AND PROCEDURES* 33-36 (1971).

63. At the end of 1972, five growth companies—International Business Machines, Minnesota Mining, American Home Products, Xerox, and Eastman Kodak—had total earnings of only 2.2 billion dollars but possessed nearly 100 billion dollars in total market value, 15 per cent of the market value of all companies on the NYSE. However, five companies with a strong earnings position—General Motors, U.S. Steel, du Pont, AT&T, and Exxon—had total earnings of 6.5 billion dollars but had a total market value of only 70 billion dollars. IBM alone equaled the combined market value of du Pont, AT&T, and Exxon. Bernstein, *Watch Earnings, Not the Ticker Tape*, 51 HARV. BUS. REV. 63, (Jan.-Feb. 1973). Classic examples of speculative enthusiasm are the tulip bulb craze in Holland from 1634 to 1638, and the South Sea Company craze in England in 1720. *See* B. MALKIEL, *supra* note 53, at 28-36.

64. *See, e.g.,* B. GRAHAM, *supra* note 55, at 81 (Chrysler Corporation, conservatively valued when earnings high, and overvalued when earnings low); *id.* at 84 (Northern Pacific Railway in 1946-1947); *id.* at 104-06 (Atlantic and Pacific Tea Company, in 1938, had a market price below asset values notwithstanding favorable earnings). Graham says that the market valued A & P at less than its liquidation value, because its market price was less than book value. This reasoning can be criticized, for liquidation value is different from accounting-asset value, and if there is no real buyer for A & P in 1938, its market price should be lower than assets. *See generally* C. HUBBARD & C. HAWKINS, *supra* note 55, at 138 (no bid price on the NYSE for Union Pacific Railroad during panic of 1907: "[M]ost people would agree that the value of a Union Pacific common share at that time was not zero. To so admit is to repair to the idea of 'intrinsic worth' of the security"); J. CLENDENIN & G. CHRISTY, *INTRODUCTION TO INVESTMENTS* 261-62 (5th ed. 1969) ("[M]any erratic moves that take place in stock prices do not appear consistent with the efficient market in the sense claimed by the random-walk theory. In 1961-1962, IBM stock rose from 387 to 607, then fell abruptly to 300 despite an uninterrupted rise in the company's sales and earnings. To say that IBM's intrinsic value changed this much seems nonsense. A simple and more plausible explanation for this price move is excessive speculation and its subsequent collapse").

intrinsic values of the shares.⁶⁵ The fact that corporations have entered the market in large numbers to repurchase their shares during the latest round of depressed prices⁶⁶ can be interpreted as implicit admissions by these companies that their stocks are undervalued.

In recent years, however, a body of economic theory and statistical evidence, known as the "efficient market" or "random-walk" hypothesis,⁶⁷ has emerged to challenge the underlying assumptions of security analysis. As explained by its supporters,⁶⁸ the random-walk theory holds that competition among participants in an efficient market⁶⁹ results in market price closely approximating intrinsic value

65. The period between 1929 and 1942 was marked by very wide swings in price. The post-World War II era has been a period of long-term improvement with a few price declines of relatively limited duration. J. LORIE & M. HAMILTON, *supra* note 55, at 7. The 1973-1974 market break was the largest percentage decline since 1937-1938. See STANDARD & POOR'S TRADE AND SECURITIES STATISTICS 4 (1974); STANDARD & POOR'S TRADE AND SECURITIES CURRENT STATISTICS 40 (Jan. 1976).

One possible explanation for wide swings in price is the tendency of investors to overreact to news of various types. See E. HELFERT, VALUATION: CONCEPTS AND PRACTICE 101-02 (1966) ("[T]he stock market . . . is subject to somewhat erratic swings, tending to overvalue favorable news and to be seriously influenced by unfavorable developments"). An often-used example of general price depression caused by unfavorable news is the assassination of President Kennedy. That event had nothing to do with the underlying economic strength of American companies; the fall in price is best explained as a function of emotion. S. ROBBINS, *supra* note 56, at 162. Another example of news which causes short-term price fluctuations unrelated to long-term value is reports of current earnings. See B. GRAHAM, D. DODD & S. COTTLE, *supra* note 53, at 478-79. See generally C. HUBBARD & C. HAWKINS, *supra* note 55, at 151; G. LEFFLER & L. FARWELL, THE STOCK MARKET 64-66 (1963); L. WHITEHEAD, *The Investors and the News*, in THE STOCK MARKET HANDBOOK 64-66 (F. Zarb & G. Kerekes eds. 1963).

66. Share repurchases during the last quarter of 1973 and the first quarter of 1974 reached record highs. Norgaard & Norgaard, *A Critical Examination of Share Repurchase*, 3 FINAN. MGMT. 44 (1974). A study of NYSE corporations in 1973 found that nearly one-third of all corporations listed dealt actively in their own shares. F. WALSH, REPURCHASING COMMON STOCK 2 (1975). Those companies making repurchases did so when the stock was selling at depressed prices based on book values, earnings and dividends. Norgaard & Norgaard, *supra* at 48; F. WALSH, *supra* at 10.

67. Efficient market theory and the random-walk hypothesis are synonymous. "If a market has zero transaction costs, if all information is costless to all interested parties, and if all participants and potential participants in the market have the same time horizons and homogeneous expectations with regard to prices, the market will assuredly be efficient and . . . prices in such a market will fluctuate randomly." J. LORIE & M. HAMILTON, *supra* note 55, at 80. This statement has been rigorously proved by Samuelson, *Proof That Properly Anticipated Prices Fluctuate Randomly*, 6 INDUS. MGMT. REV. 41 (1965); see Mandelbrot, *Forecasts of Future Prices, Unbiased Markets, and "Martingale" Models*, 39 J. OF BUS. 242 (1966).

68. See, e.g., P. COOTNER, THE RANDOM CHARACTER OF STOCK MARKET PRICES 80 (2d rev. ed. 1967); Fama, *supra* note 53; J. LORIE & M. HAMILTON, *supra* note 55, at 79-80. See also S. BOLTON, *supra* note 55, at 29-45; Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. OF FIN. 383 (1970).

69. An efficient market is a market where "there are large numbers of rational, profit-maximizers competing, with each trying to predict future market values of individual securities, and where important current information is almost freely available to all participants." Fama, *supra* note 53, at 56.

since, at any point in time, price fully reflects all available information.⁷⁰ Although different participants may disagree on a stock's intrinsic value, the actions of the competitors cause the actual price of a stock to wander randomly around its intrinsic value because individual discrepancies between price and value are random, not systematic.

The random-walk hypothesis is a perfect description of price behavior only if the stock market is perfectly efficient and frictionless; obviously such a market exists only in theory. Thus, in evaluating the applicability of the random-walk hypothesis to actual markets, it is necessary to make some determination of what constitutes threshold market efficiency, and to ascertain whether the conditions necessary to meet the thresholds exist in the actual markets. It has been argued that there are three necessary conditions for efficient markets: that information be readily available to a "sufficient" number of investors, that transaction costs be reasonable, and that, in the absence of agreement about the effect of current information and expectations regarding price movements, there be no evidence of consistent superiority or inferiority in returns achieved by significant numbers of market participants.⁷¹ While it is difficult to define these thresholds more precisely, empirical study of the New York Stock Exchange strongly suggests that conditions in that market render it efficient.⁷² Studies have proven that professionally managed portfo-

70. See *id.* New information can reflect changes in intrinsic values but, according to the theory, competition will cause the effects of the new information to be reflected instantaneously. If the awareness of the content and implications of the new information were gradual, successive price changes would "depend" on prior price changes. But if the adjustment to information is instantaneous, successive price changes are "independent," in the sense that the future course of the price of the security is no more predictable than the pattern of a series of random accumulated numbers. Fama, *The Behavior of Stock-Market Prices*, 38 J. OF BUS. 34 (1965). Accordingly, stock market prices change in a random fashion. "The random-walk theory espouses the belief that future stock prices cannot be predicted. It says that a blindfolded monkey throwing darts at the newspaper's financial pages could select a portfolio that would do just as well as one carefully selected by the experts." B. MALKIEL, *supra* note 53, at 16.

The term "random-walk" is believed to have been first used to describe the most efficient way to find a drunk left in a vacant field after a lapse of time. One should start where the drunk was left, since the drunk will presumably wander in a random fashion without purpose or design. The starting place is an unbiased estimate of his future position. Pearson & Raleigh, *The Problem of Random Walk*, 72 NATURE 294, 318, 342 (1905), quoted in J. LORIE & M. HAMILTON, *supra* note 55, at 71.

71. Fama, *supra* note 68, at 387-88. See J. LORIE & M. HAMILTON, *supra* note 55, at 80.

72. See, e.g., Ball & Brown, *An Empirical Evaluation of Accounting Income Numbers*, 6 J. OF ACCOUNTING RESEARCH 159 (1968) (found that most information contained in annual earnings announcements is anticipated by the market before the actual report is released); Crouch, *A Nonlinear Test of the Random-Walk Hypothesis*, 60 AM. ECON. REV. 199 (1970) (serial correlation tested five NYSE stocks for special conditions and found independence in pricing); Fama & Blume, *Filter Rules and Stock Market Trading*, 39 J. OF BUS. 226 (1966) (application of

lios do not consistently outperform random samples of equally risky stocks.⁷³ Moreover, some giant funds have abandoned the security analysis approach and attempted simply to match the performance of the general market indexes.⁷⁴ It seems, then, that not only public information but also the type of information available to security analysts through their individual inquiries⁷⁵ is fully reflected in stock

filter rules to the DJIA stocks found independence in price behavior); Fama, Fisher, Jensen & Roll, *The Adjustment of Stock Prices to New Information*, 10 INTL. ECON. REV. 1 (1969) (study of stock splits on the NYSE supports efficiency theory since the market makes an unbiased forecast of the implications of the split for future dividends); Granger & Morgenstern, *Spectral Analysis of New York Stock Market Prices*, 16 KYKLOS 1 (1963), (use of spectral analysis found independence in prices in stocks in Standard & Poor's Industrial Index, discussed in W. BAUMOL, *THE STOCK MARKET AND ECONOMIC EFFICIENCY* 40-41 (1965)); Mandelker, *Risk and Return: The Case of Merging Firms*, 1 J. OF FINAN. ECON. 303 (1974) (market discounts news of merger many months in advance); Reilly & Drzycimski, *Tests of Stock Market Efficiency Following Major Events*, 1 J. OF BUS. RESEARCH 57 (1973) (study of stock market effects of seven major world events found price behavior after public announcements supported efficiency theory); Scholes, *The Market for Securities: Substitution Versus Price Pressure and the Effects of Information on Share Prices*, 45 J. OF BUS. 179 (1972) (study of secondary distributions found market anticipates information implicit in the offering). For a collection of many of these studies and a more complete discussion of their significance, see J. LORIE & M. HAMILTON, *supra* note 55, at 70-97, and Fama, *supra* note 68.

73. See, e.g., WHARTON SCHOOL OF FINANCE AND COMMERCE, A STUDY OF MUTUAL FUNDS, REPORT OF THE COMM. ON INTERSTATE AND FOREIGN COMMERCE, H.R. REP. NO. 2274, 87th Cong., 2d Sess. 294-98 (1962) (found that 189 mutual funds from 1952 to 1958 did not significantly outperform an unmanaged portfolio of similar asset composition; comparisons of returns of mutual funds and an unmanaged portfolio composed of common stocks represented by the Standard and Poor's Composite Index showed few funds performing as well as the unmanaged portfolio); I. FRIEND, M. BLUME & J. CROCKETT, *MUTUAL FUNDS AND OTHER INSTITUTIONAL INVESTORS: A NEW PERSPECTIVE* 50-68 (1970); Jensen, *The Performance of Mutual Funds in the Period 1954-1964*, 23 J. OF FIN. 389 (1968); Sharpe, *Mutual Fund Performance*, 39 J. OF BUS. 119, 137 (1966). Although the evidence in these studies demonstrates profound differences among the performances of individual funds, the studies establish that no one fund over the years consistently earns better returns than a random sample. For a collection and analysis of these studies, see J. LORIE & M. HAMILTON, *supra* note 55, at 88-96. For a security analyst's survey of the evidence and his agreement with these results, see B. GRAHAM, *supra* note 55, at 119-21.

Making a profit on the market is possible if the analyst can devise a technique that is superior to those used by other analysts. That such superior techniques exist is a dubious proposition. Latane and Tuttle have suggested one such elaborate technique that they believe will maximize returns. H. LATANE & D. TUTTLE, *supra* note 53, at 518-45. However, they concede that other investors will attempt to duplicate their technique, thereby preventing the initial user from earning consistently superior returns. *Id.* at 545. See also B. MALKIEL, *supra* note 53, at 134.

74. Wall St. J., Nov. 12, 1975, at 1, col. 8. A number of major companies admitted that their pension funds have put some money into portfolios designed to match exactly Standard and Poor's 500 stock index. Performance studies by AT&T on outside pension funds found that over the past ten years, only about 20 per cent had outperformed the index.

75. Full scale analysis involves careful examination of reports filed by corporations with various state and federal regulatory commissions, annual corporate reports to stockholders, trade journals, government documents, and information gathered

prices.⁷⁶ The implication of these studies is that the high efficiency of the NYSE makes fruitless the search for securities whose price differs from intrinsic value.

The security analysis and random-walk hypotheses are clearly at odds. Although the two theories are generally advanced for the purpose of testing the viability of investment strategies, they have conflicting implications for the desirability of the stock market exception. Security analysis suggests that market price may not reflect the true or intrinsic value of a share and, accordingly, that the stock market exception, by relegating the dissenter to the market, does not guarantee him a true measure of his investment in the corporate enterprise. The random-walk theory, on the other hand, suggests that it is fruitless to seek market profits by attempting to find any value of a stock independent of its market price. This implies that the use of security analysis to appraise a stock is inefficacious. The market has already appraised the stock, and its appraisal is probably more accurate than that of any court-appointed team, since the market price reflects the collective judgment of all market participants.

The security analysis and random-walk theories posit two well-reasoned, but largely irreconcilable, views of stock market behavior. With regard to actively traded stocks, however, the statistical evidence favors the random-walk theory, and documents quite clearly the lack of consistent success experienced by investors who practice security analysis. Moreover, the market inefficiencies on which the security analysts base their theory cannot be accurately counteracted by court-appointed appraisers. These two factors justify placing presumptive reliance on the market price of an actively traded stock as a measure of the stock's value.⁷⁷

Still, it is undeniable that many stocks evidence price behavior that is not easily explained by the random-walk theory.⁷⁸ Moreover,

directly from the corporation. See B. GRAHAM, D. DODD & S. COTTLE, *supra* note 53, at 77-84.

76. Sharpe, *supra* note 73, at 138. In defense of security analysis, it is argued that professionally managed portfolios administer so large a percentage of all common stock trading that what happens to the sum of the funds must necessarily happen to the market as a whole. B. GRAHAM, *supra* note 55, at 120. Also, it is argued that any diversified portfolio of securities that is representative of the market as a whole should fluctuate roughly in the same manner as the general market. S. BOLTON, *supra* note 55, at 353. However, such conclusions probably do not justify practicing security analysis. See note 74 *supra* and accompanying text.

77. Cf. E. HELFERT, *supra* note 65, at 101.

78. Traders, investors and security analysts have generally found the random-walk theory to be unpersuasive. J. CLENDENIN & G. CHRISTY, *supra* note 64, at 261; H. SAUVAIN, *supra* note 54, at 169. One would certainly expect reluctance to accept the random-walk theory in financial circles where analysts' jobs depend on the use of the opposing security analysis theory. See Wall St. J., Nov. 12, 1975, at 16, col. 3. The objections to the random-walk theory are summarized in S. ROBBINS, *supra* note 56, at 46.

there are several important factors, explained below, that may cause a dissenter who is forced to sell his shares on the market to receive less than the full value of the shares. These factors are sufficiently important and are apt to arise with sufficient frequency to justify retaining the appraisal remedy in some form for all stocks. The dissenter who is forced to sell on the market should at least have the opportunity to prove that, because of some special factor, his sale brought him, or would have brought him, less than the full value of the stock.

2. *Factors Affecting the Dissenter's Recovery*

One special factor that may reduce a dissenter's proceeds from a market sale is the inability of dissenters who hold large blocks of stock to dispose of their stock without depressing the market price.⁷⁹ Markets for some stocks are deep enough so that large quantities of the stock can be bought and sold with minimal effect on price.⁸⁰ But for many stocks, both listed and over-the-counter, trading is so inactive that a single investor who buys or sells in large quantities can have a significant impact on the price.⁸¹ In fact, in a number of instances, the sale of numerous blocks in a short period of time has

79. A finding that block sales may depress the price, a phenomenon commonly referred to as blockage, does not mean that markets are not efficient, as that term is used with reference to the rapidity of a price's response to new information. See J. LORIE, *PUBLIC POLICY FOR AMERICAN CAPITAL MARKETS* 3 (1974). Blockage refers to technical problems that prevent the seller from selling at the prevailing price, irrespective of price accuracy or market efficiency.

Even if the dissenter does not have a large block, the coercion implicit in a dissenter's sale impairs the accuracy of market price in measuring value. Because of technical factors, blockage causes price reductions unrelated to value. Theoretically, a price decline unrelated to value occurs each time a dissenter sells. By definition, fair market price supposes the interaction of willing sellers and buyers who have assessed the merits of their investments, and who are under no compulsion to buy or sell. See *In re Dupignac's Estate*, 123 Misc. 2d 27, 204 N.Y.S. 273, 276 (Sup. Ct. 1924); *Deitch Co. v. Board of Property Assessments*, 417 Pa. 213, 209 A.2d 397 (1965); *State v. Carpenter*, 89 S.W.2d 979, 980 (Comm. App. Tex. 1936). It is true that the dissenter makes the choice not to accept the corporate action and instead to sell his stock. However, this does not make the sale voluntary since he has not decided that the timing of the sale is the most advantageous, but rather has been forced into selling at this particular time. The free market achieves an equilibrium price representative of true value because the presence of willing sellers means that the sale is "voluntary" in the sense that the seller has decided that a present sale would maximize his profits. When a dissenter is forced to sell, he is given a "now or never" choice that is dissimilar to the "wait and see" process available to the non-dissenter. The dissenter's sale increases supply and lowers the price by an amount that depends on the number of shares involved. The price is not lowered in response to the economic realities of the value of the company, but because the dissenter has no alternative to selling his shares.

80. See Scholes, *supra* note 72, at 182.

81. See H. SAUVAIN, *supra* note 54, at 166-67.

resulted in a large drop in market price, and has even caused the temporary suspension of trading in the securities involved.⁸²

A market that is capable of absorbing a block of stock without any appreciable price decline possesses adequate "liquidity and depth."⁸³ It is difficult to determine, however, what conditions must exist before a market has sufficient liquidity and depth. The stock exchanges, in adopting listing and delisting standards, have implicitly defined what they consider to be the necessary conditions. The exchanges reason that depth depends to a large degree on the supply of stock in the hands of the public, and thus the exchanges rely heavily on the "floating supply" as an important listing criterion.⁸⁴ Yet the listing and delisting standards for the most part have been arbitrarily determined.⁸⁵ The listing of a stock on an exchange, therefore, does not ensure adequate depth.⁸⁶ "Floating supply" can be a particularly misleading criterion, since increasing institutionalization has had the effect of concentrating the shares of many small investors under the control of a few managers, who make investment decisions on behalf of their investors.⁸⁷ This concentration decreases liquidity and depth because transactions become more infrequent and irregular, and small investor participation decreases.

The dissenter who sells a block of shares on a market that lacks sufficient liquidity and depth must accept a price lower than the prevailing price. He thus receives less than the full value of his shares even if the prevailing market price accurately reflects their full

82. SEC, PUBLIC POLICY IMPLICATIONS OF INVESTMENT COMPANY GROWTH 302 (1966).

83. The 1963 SEC Study defined many of the terms commonly used to describe market characteristics. In a "continuous" market, each transaction is reasonably related in price to the prior transaction, with minimum price variations or deviations. In a "liquid" market, a willing seller is readily able to find a willing buyer. The extent to which the term implies that a transaction occurs at a price closely related to intrinsic worth is an open question. "Depth" describes the market for a particular security by referring to the quantity of buying and selling interest and the potential activity on each side of the market. Depth is primarily a function of the total amount of the class of securities outstanding (the "float") and the breadth of distribution among the general public, exclusive of amounts concentrated in large blocks. 1963 SEC STUDY, *supra* note 43, at 13-18. See generally Wolfson, Rosenblum & Russo, *The Securities Markets: An Overview*, 16 *How. L.J.* 816-19 (1971).

84. See, e.g., 2 CCH NYSE GUIDE ¶ 2495B.10, at 4225-26 (1975). See also 1963 SEC STUDY, *supra* note 43, at 828.

85. S. ROBBINS, *supra* note 56, at 158.

86. Considerable concern continues to exist regarding the maintenance of adequate depth. NYSE rule 104 states that "maintenance of a fair and orderly market implies the maintenance of price continuity with reasonable depth, and the minimization of the effects of temporary disparity between supply and demand." 2 CCH NYSE GUIDE ¶ 2104.10, at 2701-5 (1975). 17 C.F.R. Sec. 240.11b-1 (1975) demonstrates SEC concern over conditions of market depth. This regulation added the concept of depth to the obligations of the specialists. SEC SECURITIES EXCHANGE ACT OF 1934 RELEASE No. 7432 (Sept. 24, 1964).

87. See note 23 *supra*.

value. In such a situation, the investor with a large block can either accept a severe price penalty in order to effect an immediate sale of his shares, or he can delay his transaction.⁸⁸ For the dissenting shareholder, of course, delay is often not possible, and the price penalty is the only alternative to becoming a part of the new enterprise.

That "blockage" might often confront the dissenting shareholder is confirmed by the widely recognized existence of the problem in the context of valuation practices in tax litigation. In tax valuation, the principle that the size of a taxpayer's block can be relevant in deciding the value of the stock is firmly established.⁸⁹ In a valuation proceeding, the taxpayer has the opportunity to demonstrate that the size of his block of stock is such that it could not be sold at the prevailing market price, and that he is thereby entitled to pay taxes based on the value of his stock at some level lower than the prevailing price. Courts determine this by finding the highest value at which the stock could be sold if the owner were to liquidate his stock on the best terms available.⁹⁰ Where applied, this formula has resulted in findings that this "highest value" is below the prevailing market quotations for shares of stock listed on active exchanges.⁹¹

The manner in which large blocks are currently sold demonstrates that the dissenter usually will have difficulty trying to dispose of such a block. Clearly, large blocks are difficult to sell on exchange auction markets without depressing the prevailing price.⁹² The most popular way to dispose of large blocks of securities is to split them into small units and to sell them over a period of time, which may extend for several months.⁹³ Block trades do occur frequently in the

88. *Hearings on the Securities Industry Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 92d Cong., 2d Sess., pt. 6, at 2949 (1972).

89. See *Helvering v. Maytag*, 125 F.2d 55 (8th Cir. 1942); *Citizens Fidelity Bank & Trust Co. v. Reeves*, 259 S.W.2d 432 (Ky. App. 1953); Treas. Reg. § 20.2031-2(e) (1958). See generally Wiley, *Valuing Large Holdings of Publicly Traded Stocks: "The Blockage" Problem*, 8 INSTITUTE ON ESTATE PLANNING ¶ 74.8 (1974).

90. *Bull v. Smith*, 119 F.2d 490, 492 (2d Cir. 1941).

91. See, e.g., *Groff v. Munford*, 150 F.2d 825 (2d Cir. 1945) (affirms finding that sale of block on Montreal Stock Exchange through brokers in a narrow time period would substantially depress the price); *Andrews v. Commissioner*, 135 F.2d 314 (2d Cir. 1943) (block on over-the-counter market held to be worth less than the market price); *du Pont v. Commissioner*, 2 T.C. 246 (1943) (block of 52,900 shares of 11 million outstanding could not have been sold at prices that would average quoted prices for the stock on the NYSE, but would be 15 points lower); *Bartol v. McGinnes*, 185 F. Supp. 659 (E.D. Pa. 1960); *Knobloch v. Smith*, 25 F. Supp. 156 (D. Conn. 1938); *Florida Natl. Bank v. Simpson*, 59 S.2d 751, 767-73 (Fla. 1952).

92. L. WRIGHT, *PRINCIPLES OF INVESTMENTS: TEXTS AND CASES* 57 (1972).

93. S. ROBBINS, *supra* note 56, at 223, 228; *Hearings on the Securities Industry*, *supra* note 88, at 2950. It has been suggested that spreading a block sale over a long period of time would depress the price as much as selling the entire block at once, *Calvert v. Kattar*, 301 S.W.2d 318, 321 (Tex. Civ. App. 1957); SEC, *PUBLIC POLICY*

market, but the sellers must either accept a discount from the current market price or pay a premium to effect the transaction.⁹⁴ Since many of these block transactions may not be completed for many months,⁹⁵ faster disposition of the stock would require greater discounts or higher premiums. The stock exchanges, recognizing that the floor sale of a large block can distort the prevailing price, have developed several alternative mechanisms.⁹⁶ While these mecha-

IMPLICATIONS OF INVESTMENT COMPANY GROWTH 301 (1966). However, a comprehensive study of share repurchasing demonstrates that a number of small-scale transactions will maintain an orderly market, while a massive transaction will create a disorderly market. See C. ELLIS & A. YOUNG, *THE REPURCHASE OF COMMON STOCK* 170-76 (1971). The authors found that tender offers dry up the trading volume in common stock, while open market transactions did not appear to have any noticeable effect on security trading or volume, or on the depth of the trading market. The study concluded that, since tender offers having substantial premiums above market price in order to attract sufficient shares create a disorderly market, a number of small-scale repurchases are more desirable. It follows that a number of small-scale sales will not impair the market's orderliness as would one mass sale based on a substantial reduction in price. See also Wiley, *supra* note 89, at ¶ 74.800. *Contra*, Scholes, *supra* note 72, discussed in R. BREALEY, *SECURITY PRICES IN A COMPETITIVE MARKET* 81-94 (1971). The Scholes article suggests that those price declines that do occur are not caused by the inability of an undercapitalized, thin market to digest the large transaction, but rather are caused by information, implicit in the sale, which is interpreted to portend bad news. This is further evidence that a dissenter is unable to obtain the value of his shares unaffected by any appreciation or depreciation caused by the corporation's action. See notes 107-14 *infra* and accompanying text. However, it is difficult to accept the view that all stocks possess sufficient depth to absorb any size transaction. The depth of a stock's market is unique to the particular float; thus markets in certain stocks may be deep enough to absorb a block, while others may not. 1963 SEC STUDY, *supra* note 43, at 898. In addition, Scholes' work does not account for the unique problem facing the dissenter, namely that the dissenter must dispose of his stock much more quickly than those sellers described in Scholes' work. Quicker sale must necessarily result in more drastic price behavior as a consequence of the more rapid increase in the supply.

94. IIS REPORT at 1819.

95. On the average, only one eighth of a block is sold on the first day, and less than one half is sold in the first week. Seven per cent generally remains at the end of the month. *Id.* at 1821.

96. The most popular mechanism is the secondary distribution, which in recent years has accounted for over one per cent of NYSE volume. R. BREALEY, *supra* note 93, at 83. The secondary distribution occurs after trading hours and off the floor of the exchange. The price generally does not exceed the last sale price of the security on the floor at the time of the offering. With the approval of the exchange, certain commissions may be added to the offering price. The seller pays a commission generally equal to twice the normal rate and the buyer pays no commission. The exchange distribution involves a group of member firms soliciting enough buy orders to match a block sell order. The member selling the block pays a special commission to the members agreeing to solicit purchasers and, in order to stimulate demand, may also pay the buying commissions.

A second mechanism is the "special offering" of a block at a fixed price for sale through the facilities of the exchange. The sale price does not exceed the current price of the security in the regular market and is no lower than the current bid. The offeror pays a commission to those who accept any part of the offering. The commissions paid by the offeror are used to recruit a sales force that hopefully will generate additional demand. The seller also may pay the buying commissions, thus lowering the buyer's net price. See generally CCH NYSE GUIDE ¶¶ 2392-93, at 3667 (1975); Wiley, *supra* note 89, at ¶ 74.805.

nisms do allow the dissenter to dispose of his stock, all involve costs that decrease the dissenter's actual net recovery, although not by as much as a sale on the floor of the exchange.⁹⁷

In short, the dissenter with a large block of stock cannot dispose of his shares on the market without a reduction in its price, and thus cannot obtain the full value of his interest in the old corporation. Off-market mechanisms can reduce the loss, but not eliminate it entirely. The appraisal remedy is a suitable instrument for correcting the effects of blockage, since a dissenter could demonstrate in an appraisal proceeding the amount of loss he suffered or would have suffered.

A second problem faces the dissenter whose stocks are listed on a minor exchange. The stock market exception applies to stock listed on the regional markets that are registered with the Securities Exchange Commission, as well as to those listed on the national markets. The regional exchanges are distinctly smaller in size⁹⁸ and probably

97. See Appeal of McNeil, 435 Pa. 553, 556, 257 A.2d 835, 837 (1969) (expert witness said secondary distribution of a block of stock, the most practical and economic method to dispose of the shares, would involve six per cent decrease in the market price of the shares). In the case of a secondary distribution, the average additional cost to the seller is almost three per cent, R. BREALEY, *supra* note 93, at 91. It can be argued that the dissenter would have to pay the costs of a block sale at some point in any event. However, forcing the dissenter to sell his block immediately deprives him of the opportunity to sell in small quantities on the exchange, thereby avoiding the additional costs of a large transaction.

98. See note 5 *supra*. Of the 13 registered exchanges, only nine were trading common stocks as of July 1, 1976. The Chicago Board of Trade suspended securities trading in March 1971, 39 SEC ANN. REP. 62 (1973), the National Stock Exchange folded in January 1975, N.Y. Times, Jan. 1, 1975, at 22, col. 2 (late city ed.), the Chicago Board Options Exchange has ceased common stock trading, SEC, 35 STAT. BULL. 165 (April 1976), and the Detroit Stock Exchange suspended such trading on June 30, 1976, Telephone Conversation with spokesman of Detroit Stock Exchange, July 3, 1976. Of the 11 active exchanges, the NYSE and the AMEX are the only two that can truly be considered national. The rest help finance local industries in various geographic areas and provide a market for their securities. *The Regional Stock Exchanges Fight for Survival*, 88 FORTUNE 118 (Nov. 1973). The dominance of the NYSE is evident from the fact that while the number of stocks traded on the NYSE is substantially less than ten per cent of the total number of publicly traded shares, the value of the shares is about two-thirds the total value of all publicly traded shares. J. LORIE & H. HAMILTON, *supra* note 55, at 5. Only 0.1 per cent of all U.S. companies are listed on the NYSE, but preliminary data for 1972 reveals that this small percentage possesses 58.4 per cent of the total assets, 41.9 per cent of the total sales, and 86.0 per cent of the net income of all U.S. corporations. 1975 NYSE FACT BOOK 34.

For the most part, the regional exchanges serve as a dual market for securities. About 90 per cent of the stocks traded on the regional exchanges are also listed and have their primary markets on the NYSE or AMEX. 88 FORTUNE 118 (Nov. 1973). Almost two thirds of all NYSE stocks are traded on other exchanges. 1963 SEC STUDY *supra* note 43, at 1083. Excluding the mining exchanges, 11 per cent of the stocks on regional exchanges were listed solely on those exchanges. During the two-month period under study, this 11 per cent accounted for 32.6 per cent of total shares volume and 7.0 per cent of total dollar volume. *Id.* at 1084. Though the regional exchanges currently conduct only a relatively small percentage of total share trading, as a percentage of dollar volume, the regional exchanges have steadily increased their

much less efficient than the larger exchanges. In particular, the regional exchanges are characterized by a lower level of activity and a lesser number of participants. Consequently, a seller with even a moderately sized block may have difficulty selling it on a regional market.⁹⁹ His problems are reduced if his stock is also listed on a national exchange, but they are by no means eliminated.¹⁰⁰ Cognizant of the differences between the regional and national exchanges, courts have been reluctant to give prices on regionals exclusive weight in valuation proceedings.¹⁰¹

trading share. In 1973, total dollar volume of regional trading exceeded 21 billion dollars, and total trading volume exceeded 652 million shares. 40 SEC ANN. REP. 158 (1974). As for share volume, the most striking trend is the decline of the smaller regional exchanges, and a concentration of regional trading in the Midwest Stock Exchange, the Pacific Stock Exchange, and the PBW Stock Exchange. The growth in these three exchanges has sufficed to sustain a general increase in the regional exchanges' share of dollar volume, even though the three largest regionals do about 90 per cent of the total business of all regional exchanges. See 39 SEC ANN. REP. 155 (1973).

99. Eisenberg, *supra* note 39, at 82. Specialists are reluctant to make a market on regionals in the more inactive issues. 1963 SEC STUDY, *supra* note 43, at 949.

100. It is argued that, because of dual listing, most shares listed on regional exchanges do have a ready market on the national exchange, and therefore differences between the regional and national markets are not important. It is probable that dual listing has assisted in the disposition of large blocks because the block can be split and disposed of in several markets. 1963 SEC STUDY, *supra* note 43, at 942. Dual trading has also been in the most active issues with the largest number of shareholders, so that the quality of the market has generally not been impaired. *Id.* at 941, 949.

However if a large percentage of a particular stock is taken off the NYSE and traded on a regional, the float on the NYSE in that security is reduced. This reduction can impair liquidity and depth in that issue and thereby cause inefficiency in price determination. Thus, dual listing does not guarantee that the seller will always be able to participate in a deep and liquid market. *Id.* at 949.

101. See, e.g., *Bauman v. Advance Aluminum Castings Corp.*, 27 Ill. App. 2d 178, 169 N.E.2d 382 (1960), where the court said that market quotations would not be exclusive even though the stock was listed and traded on the Midwest Stock Exchange. 27 Ill. App. 2d at 182, 169 N.E.2d at 386-87. If *Bauman* were decided under a stock-market exception statute, market price would control. However the court upheld an appraisal value of \$11.50 per share, although the market price was only \$8. In *Gallois v. West End Chem. Co.*, 185 Cal. App. 2d 765, 8 Cal. Rptr. 596 (1960), a dissenter sought appraisal of his widely traded over-the-counter shares pursuant to a California statute that called for the payment of "fair market value." The court placed a great deal of reliance on the price established in a broad market, 185 Cal. App. 2d at 774-75, 8 Cal. Rptr. at 602, and stated that the purpose of the amendments to the California statute making "fair market value" the standard and giving the court the option to appoint appraisers was to make market price controlling where a trading market existed. 185 Cal. App. 2d at 771-72, 8 Cal. Rptr. at 600. Even so, the *Gallois* court indicated that market quotations would not be conclusive. If the dissenter were able to provide evidence of manipulation of the market price, failure of management to disclose inside information, or errors in market price due to the effects of the merger, appraisal would be granted. It was the inability of the dissenter to document an error in the price that the court noted in affirming the use of market quotations. 185 Cal. App. 2d at 774-75, 8 Cal. Rptr. at 602. The court, however, rejected the notion of intrinsic value, and indicated that in any case where the market is fair, market price would be used:

Many writers prefer some other definition [of value], such as our former "fair

Because regional markets are not active enough to justify exclusive reliance on price, those who appraise regionally listed stocks should use security analysis techniques to determine value. Essentially, the valuation problem in this situation is no different than the problem of valuing the stock of a close corporation that lacks a cognizable market. Of course, the exchange price is evidence of value, which the appraisers could weight in accordance with the level of market activity for the particular stock.¹⁰²

The stock market exception creates a third difficulty, unrelated to the problems of fair pricing, for the dissenter who owns restricted securities.¹⁰³ A significant number of stocks are placed through

cash value," or as "intrinsic value," or "real value" or "fair value," etc. We do not know what those terms mean or others like them mean, and we suspect that the writers who advocate them do not know either. They use them because they distrust the market as a gauge of value. Yet realistically, under our economic system, the value of any item of property on any given date, in monetary terms, is what it can be sold for in a free and fair market.

185 Cal. App. 2d at 774, 8 Cal. Rptr. at 601-02.

102. The problem of inefficiency on the regional exchanges will be alleviated when the central market system is adopted. As defined by the SEC, the proposed central market system will be a nationwide communication system linking together all elements of the securities marketplace, including all exchanges, national and regional, and the over-the-counter markets. The nationwide system of disclosure will make data on price and value in all markets universally available and will eliminate any barriers to participation in any market. SEC, STRUCTURE OF A CENTRAL MARKET SYSTEM 11 (1973). Accordingly, the central market should ease the problem of inadequate depth and liquidity in regional markets, by making these markets part of a national system tied together by computer. See generally *id.*; 40 SEC ANN. REP. 7 (1974); J. LORIE, *supra* note 79. However, with stocks traded exclusively on regional markets, the central market will not increase efficiency, since the size of the float will not change.

103. "The term 'restricted security' is defined to mean securities acquired directly or indirectly from an issuer, or from a person in a control relationship with such an issuer (an affiliate) in a transaction or chain of transactions not involving any public offering." SEC RELEASE No. 5223, [1971-1972 Transfer Binder] CCH FED. SEC. L. RPTR. ¶ 78,487 at 81,055 (Jan. 11, 1972). The Securities Act of 1933, 15 U.S.C. §§ 77(e), (f) (1970) requires a corporation that desires to sell its shares to the public to file a detailed registration statement with the SEC and deliver a prospectus to each offeree. However, there is an exception from registration for "transactions by an issuer which do not involve a public offering." 15 U.S.C. § 77d(2). SEC rule 144 is intended to clarify the exception to registration that allows issuers to make isolated sales to a limited number of persons who have sufficient information so that they do not need the protection of the disclosure requirements of the act. SEC RELEASE No. 5223, [1971-1972 Transfer Binder] CCH FED. SEC. L. RPTR. ¶ 78,487 at 81,050-81,055 (Jan. 11, 1972). Underlying this rule is the concern that the sale might become the first step in a wider distribution. If that were to occur, the securities might reach investors who lack the information necessary to make informed investment decisions. Thus, rule 144 attempts to detail the conditions under which resale of securities originally acquired in a private offering is not considered part of a distribution.

Registration is expensive; the total costs may range from three per cent of the gross proceeds in a large offering to nearly 20 per cent of the proceeds in a small one. Note, *Resale of Restricted Securities Under SEC Rule 144*, 81 YALE L.J. 1574, 1579 (1972). Private placement of securities, because of this expense and the time necessary to the investigation for registration, has become an "attractive, if not

private offerings and thus become restricted securities.¹⁰⁴ Because there is often little public information about their underlying value, the Securities Exchange Commission has limited the quantity of such shares that can be sold on the market. SEC rule 144, adopted in 1972, states that, for securities listed on a national exchange, the number of restricted or other securities sold in any six-month period may not exceed the lesser of two amounts: either one per cent of the shares outstanding¹⁰⁵ or "the average weekly reported volume of trading in such securities on all securities exchanges during the four calendar weeks" that precede the filing of the required notice of the proposed sale.¹⁰⁶ The effect of this rule is to reduce the liquidity of a block of stock acquired through a private offering. Because the dissenter has relatively little time to sell his stock before the enterprise changes form, any restriction on the amount that can be sold threatens the only recourse a dissenter has under the stock market exception. In this event, the dissenter is precluded from even receiving the market value of his interest in the corporation. Appraisal and corporate repurchase offer the only feasible alternative to the shareholder. Any state that chooses to retain some vestige of the stock market exception should make an accommodation for restricted securities.

A fourth problem is generated by the speed with which the market place reacts to the news of a major corporate action.¹⁰⁷ Because appraisal theoretically compensates the dissenter for his share in the original corporation,¹⁰⁸ appraisal statutes are nearly unanimous in stating that the dissenter is entitled to the value of his shares unaf-

indispensable" instrument for corporations attempting to raise capital. Note, *Rule 144: SEC Regulation of Dispositions of Securities by Controlling Persons and Private Places*, 25 VAND. L. REV. 845, 846 (1972).

104. In 1973, the value of privately marketed issues increased for the third year in a row, totaling 12.2 billion dollars, a record high. 1.6 billion dollars was placed privately in 1973, which was 23 per cent higher than in 1972, and four and a half times greater than in 1971. 1974 NYSE FACT BOOK 69. In the period 1960-1963, over 40 per cent of all new corporate offerings were private placements. S. ROBBINS, *supra* note 56, at 171.

105. For purposes of determining the one per cent, both restricted and unrestricted securities of the same class are aggregated. Thus, this rule applies to any block of stock, any part of which is restricted.

106. 17 C.F.R. § 230.144(e)(1)(i) (1975).

107. This concern frequently surfaced in judicial opinions. See, e.g., *Vought v. Republic-Franklin Ins. Co.*, 117 Ohio App. 389, 192 N.E.2d 332 (1962); *Application of Silverman*, 115 N.Y.S.2d 97 (1952), *modified on appeal*, 282 App. Div. 252, 122 N.Y.S.2d 312 (1st Dept. 1953).

108. In many cases, minority shareholders may be paid a premium for their shares in the old corporation in order to avoid dissent and to facilitate a corporate action. According to one study, stockholders in acquired corporations in mergers have received an average premium above the market price of 25 per cent; in one fifth of the instances, the premium was 50 per cent above market price. R. BREALEY, *supra* note 93, at 51; Kipp & Wallum, *Acquisitions and Attendant Shareholder Rights*, 23 RUTGERS L. REV. 723, 726 (1969). Minority shareholders who accept such offers, of course, are not dissenters.

affected by any depreciation or appreciation that might be caused by the corporate action from which he dissents.¹⁰⁹ However, to the extent that market price instantaneously reflects new information, a dissenter cannot sell on the market at a price unaffected by the information implicit in the new corporate action. Obviously, where a major corporate action is considered desirable by analysts, the market price will adjust itself upward; but where the action is considered improvident, the price will fall.¹¹⁰ To force the dissenter to sell in a falling market subjects him to the influence of the corporate action against which he seeks a remedy.¹¹¹

Appraisal can control for such abnormal price fluctuations by using the price that prevailed before the market began to adjust for the action.¹¹² To control for the effects of the corporate action, an appraiser would need to determine at what point information concerning the impending action began to affect the market. The period evaluated could, in some cases, extend several months prior to the public announcement.¹¹³ Appraisers could evaluate the degree of the action's impact, controlling for other events, and adjust the market price accordingly.¹¹⁴

Finally, there are numerous other factors that can cause the market price to deviate from the intrinsic value of a share that even appraisal will often be unable to solve. For example, manipulation of information by insiders of the corporation,¹¹⁵ speculative price movements

109. See, e.g., DEL. CODE ANN. tit. 8, § 262(b) (1975); N.Y. BUS. CORP. ACT § 623(h)(4) (McKinney 1963); WIS. STAT. ANN. § 180.72(2) (Supp. 1975).

110. Evidence as to the performance of common stocks of acquiring companies in mergers, whether measured by price or earnings of the corporation, suggests that mergers since World War II have not been particularly beneficial to the companies involved. When compared to other industries, the acquiring corporations have experienced both inferior earnings growth and price declines in their common stock. R. BREALEY, *supra* note 93, at 57.

111. See Note, *supra* note 24, at 1144.

112. Many appraisal statutes attempt to control for the market's anticipation of a corporate action by using market value the day before the shareholder votes. See note 2 *supra*. However, if the studies showing that the market discounts the corporate action many months before the event are accurate, see note 72 *supra*, then discounting one day in advance hardly controls for the effect of the corporate action.

113. See Mandelker, *supra* note 72; Scholes, *supra* note 72.

114. A similar analysis is used in assessing damages in some rule 10b-5 cases, where the calculation involves measuring the difference between what was received in the fraudulent transaction (market price) and the value of what was given up (market price plus or minus the increment for appreciation or depreciation caused by the fraudulent practice). R. JENNINGS & H. MARSH, *SECURITIES REGULATION: CASES AND MATERIALS* 1186 (1972).

115. One rationale for the adoption of securities regulation is that prices of securities on exchanges and markets are susceptible to manipulation and control, resulting in unreasonable fluctuations in their price, that consequently hinder proper appraisal. Securities and Exchange Act of 1934 § 2(3), 15 U.S.C. § 78(b)(3) (1970); SEC v. Torr, 15 F. Supp. 315, 318 (S.D.N.Y. 1936). The 1963 SEC STUDY of the securities markets found evidence that corporate public relations

based on psychological factors.¹¹⁶ and a parent's manipulation of the subsidiary's price¹¹⁷ can all create discrepancies between price and value. Rule 10b-5 protects the shareholder from fraudulent information when a purchase or sale of the security is involved.¹¹⁸ Moreover,

departments regularly attempt to increase the price of a company's stock by creating a favorable investment image, that is only tangentially related to the true status of the company:

[A]buses of the financial public relations function have become increasingly evident. . . . [T]he Commission and its staff have become aware of disturbing signs that public relations consultants and corporate public relations departments have been used for purposes contrary to the letter and the spirit of the securities acts Several instances have come to light in which it has appeared that misleading publicity has directly affected the market price of securities.

1963 SEC STUDY, *supra* note 43, at 67. The study cited several examples of successful manipulations which increased market price, *id.* at 67-72, and also showed that skillful use of a single item of financial publicity can have the effect of depressing a stock's price to the advantage of majority shareholders. It concluded that "the motives underlying public relations activity may be of several kinds or may be mixed. . . . The essential point is that the investor who relies on publicity that is overenthusiastic or incorrect may be injured, regardless of the purpose of those who are responsible for it." *Id.* at 78.

116. See note 62 *supra*.

117. It has been suggested that control of market price is a serious problem in the context of the parent-subsidiary merger. Management may have information that is not disclosed and therefore not reflected in a subsidiary's price, such as an anticipated increase in the subsidiary's earnings. Judicial emphasis on market price would be likely to underestimate the future earnings, and thus the value, of the current enterprise of which the dissenter is a part. Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 305-06 (1974). In addition, the parent can exert influence that depresses the price of the stock. Accordingly, any reliance on market price to measure appraisal value reflects the "cost of the parent's control" in measuring the dissenter's interest. *Id.* citing *In re Talley Indus.*, SEC RELEASE No. 5953, [1969-1970 Transfer Binder] CCH FED. SEC. L. RPT. ¶ 77,774, at 83,783, 83,792 (Jan. 28, 1970) (rejected use of NYSE price of stock in evaluation of fairness of proposed merger between two investment company affiliates in a parent-subsidiary relationship pursuant to section 17(b) of the Investment Company Act of 1940). Management can control the statement of earnings, an important factor in appraising value, because of different or inconsistent, but acceptable, accounting principles. W. CARY, *supra* note 34, at 1241.

118. Rule 10b-5, promulgated under the Securities Exchange Act of 1934 § 10, 15 U.S.C. § 78j(b) (1970), makes it unlawful "to make any untrue statement of a material fact or to omit . . . a material fact necessary in order to make statements not misleading . . . in connection with the purchase or sale of any security." 17 C.F.R. § 240.10(b)-5 (1975). Thus, false predictions of earnings, misstatements in earnings reports, false news, or news omitting a material fact that produces misleading result, or any misleading statement designed to depress or raise the price of a stock is within the scope of rule 10b-5. 2 A. BROMBERG, *SECURITIES LAW* 143-62 (1954). This remedy can protect the dissenter from any unfairness in market price caused by fraudulent insider behavior. Regardless of whether a state appraisal statute is the exclusive remedy, courts will entertain rule 10b-5 actions as a matter of overriding federal law. Rights and remedies available under rule 10b-5 are "in addition to any and all other rights and remedies that may exist at law or equity." 15 U.S.C. § 78bb(a). Thus, where a shareholder alleges a violation of the rule and thereafter demands an appraisal as provided by state law, the shareholder is not making an election of remedies that bars his suit under 10b-5. *Green v. Santa Fe Indus., Inc.*, No. 75-7256 (2d Cir. Feb. 18, 1976), at 1949; *Voegel v. American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965). Rule 10b-5 requires a purchase or sale of

if the misleading information rises to the level of "fraud" or "bad faith," most states allow an equitable remedy, even if appraisal is otherwise an exclusive remedy for a corporate action.¹¹⁹ All of these problems, though, are based on an absence of information or on inaccurate information. If the shareholder can do so, he should have the opportunity to demonstrate that the market price has been improperly influenced by such factors and that it consequently does not reflect intrinsic value. In most cases, however, appraisers will be unable to discover information in an appraisal proceeding that has been unavailable to the market as a whole. In these situations, market price, though incorrect, may be the best available indication of value.

3. *Judicial Approaches Toward Stock Valuation*

The unreliability of market price as an exclusive determinant of value is strongly supported by the judicial approaches toward stock valuation. Since the turn of the century, courts have used a variety of analytical approaches to value shares,¹²⁰ and have been attracted to the standard of market value because of its easy application.¹²¹ Yet, the decisions as a whole demonstrate a general reluctance to rely exclusively on market price in determining value.

In the early twentieth century, some courts used market price exclusively, when it seemed fair, on the ground that it reflected the opinion of those informed about the value of the company in question.¹²² But courts at this time commonly believed that a share of

securities. For purposes of the rule, securities are considered purchased and sold in mergers, consolidations, and sale of assets for securities. *SEC v. National Sec. Co.*, 393 U.S. 453 (1969). If successful, the dissenter suing under 10b-5 in an action based on price manipulation would receive the difference between the value of what he gave up and what he received in the transaction. *R. JENNINGS & H. MARSH, supra* note 114, at 1186. Furthermore, minority shareholders could get an injunction halting the actions depressing market price. *See Mutual Shares Corp. v. Genesco Inc.*, 384 F.2d 540, 546-47 (2d Cir. 1967).

119. Note, *supra* note 22, at 115, 119-20.

120. For a survey of the various factors considered in appraising closely held and publicly held stock, see Note, *Valuation of Dissenter's Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453 (1966).

121. *See Tanner v. Lindell Ry.*, 180 Mo. 1, 79 S.W. 155 (1904) (dissenters entitled to "market value," but no indication of what market value is based on). *See also American Seating Co. v. Bullard*, 290 F. 896, 902 (6th Cir. 1923); *Jackson Co. v. Gardiner Inv. Co.*, 217 F. 350 (1st Cir. 1914), *appeal dismissed*, 239 U.S. 628 (1915).

122. *See Homer v. Crown Cork & Seal Co.*, 155 Md. 66, 141 A. 425 (1928), where the court attempted to value minority shares to determine whether the sale of a corporation's assets was at a fraudulently low price. The court stated that, although market price is influenced by many conditions and hence may not be exclusively relied upon, it is more likely to reflect the actual worth of the company's assets than book value, "since [market price] is subject to constant revision and is the consensus of financial opinion as expressed by those best informed while engaged in the

stock represented a portion of the corporation's assets. They therefore rejected market price when it fell below asset values, and sought to determine a value apart from market price.¹²³

The stock market plunge that began in October 1929 shook public confidence in the protection capabilities of the free market.¹²⁴ In response, courts in the 1930's gave less or even no weight to market price¹²⁵ and began to look to other factors, such as those used in

competitive selling and buying of the assets of the corporation." 155 Md. at 81, 141 A. at 432. See also *In re Capital Stock of Morris Canal & Banking Co.*, 104 N.J.L. 526, 141 A. 784 (Ct. Err. & App. 1928).

123. See, e.g., *Cole v. Wells*, 224 Mass. 504, 512-13, 113 N.E. 189, 191 (1916) ("It is obvious that 'the value of the stock' means not merely the market price if the stock is traded in by the public, but the intrinsic value, to determine which all the assets and liabilities must be ascertained"); *Petry v. Harwood Elec. Co.*, 280 Pa. 142, 124 A. 302, 304 (1924) (dissenters "entitled to receive the real, actual value of their shares . . . market value does not measure this real, actual value").

Tax valuations prior to the depression also reflected a belief held by some courts that market price should not necessarily be decisive of a stock's value. In *Heiner v. Crosby*, 24 F.2d 191 (3d Cir. 1928), the court rejected the use of market quotations on the Pittsburgh Stock Exchange to determine the amount of income tax on the sale of stock and upheld the lower court's findings on intrinsic value. The court stated that market price may be significant but not decisive and that "peculiar or unusual circumstances, such as sales of small lots, forced sales, and sales in a restricted market" could so disturb a market as to make the prevailing price unreliable. 24 F.2d at 193. *Contra*, *Klein v. Jefferson City Bd. of Tax Super.*, 230 Ky. 182, 18 S.W.2d 1009 (1929), *affd. on other grounds*, 282 U.S. 19 (1930).

The techniques used in valuing stock for federal estate or gift tax purposes have been regarded as inapplicable for the appraisal of dissenters' shares, since in a tax valuation the owner of the stock does not part with his investment, while in appraisal, the stockholder surrenders his opportunity to share in the future growth of the company. Additionally, in tax valuation the corporation is not affected by the outcome, while in appraisal, the corporation's interests are directly involved. Note, *supra* note 120, at 1455. Tax valuation, however, is not irrelevant to appraisal, for the tax decisions give insight into judicial attitudes toward particular valuation standards. It is arguable whether courts attach any significance at all to the distinction between tax valuation and appraisal valuation. See *Clark v. City of Burlington*, 101 Vt. 391, 400, 143 A. 677, 681 (1928) ("assessment" refers to official valuation of property for tax purposes, and is synonymous with the word "appraisal" used in the stock appraisal statute). Moreover, because the consequences of appraisal involve the exchange of property for cash and are hence more severe than tax valuation, the standards used in appraisal should be more accurate. Banks, *Measuring the Value of Corporate Stock*, 11 CAL. WEST. L. REV. 1, 35-36 (1974). Thus, if a tax court performing a tax valuation rejects a standard on grounds of inaccuracy or unfairness, the standard should be even more closely scrutinized before being employed to appraise the dissenter's shares.

124. See, e.g., B. REIS, *FALSE SECURITY* 260-72 (1938).

125. See, e.g., *Chicago Corp. v. Munds*, 20 Del. Ch. 142, 172 A. 452 (1934), where dissenters to a merger sought appraisal under the Delaware statute. The appraisers used the closing market quotations of the stock on December 20, 1932, and the court stated:

When it is said that the appraisal which the market puts upon the value of the stock of an active corporation as evidenced by its daily quotations, is an accurate, fair reflection of its intrinsic value, no more than a moment's reflection is needed to refute it. There are too many accidental circumstances entering into the making of market prices to admit them as sure and exclusive reflectors of fair value. The experience of recent years is enough to convince the most

security analysis.¹²⁶ The extremely erratic market of the Depression stabilized after World War II, and showed a sustained period of over-all improvement in prices.¹²⁷ In this new period, courts demonstrated greater willingness to use market price as a determinant of value, but declined to use it exclusively in most cases on the ground that circumstances could exist that would compel modification or rejection of market quotations.¹²⁸ Courts, for instance, indicated that

casual observer that the market in its appraisal of values must have been woefully wrong in its estimates at one time or another within the interval of a space of time so brief that fundamental conditions could not possibly have become so altered as to affect true worth. Markets are known to gyrate in a single day.

20 Del. Ch. at 150, 172 A. at 455. *Accord*, *Ames v. Godchaux Sugars, Inc.*, 229 App. Div. 858, 243 N.Y.S. 798, *affd.*, 256 N.Y. 676, 177 N.E. 189 (1931), *discussed in* Robinson, *Dissenting Shareholders: Their Right to Dividends and the Valuation of Their Shares*, 32 COLUM. L. REV. 60, 62, 72 (1932). *See* *Republic Fin. & Inv. Co. v. Fernstermaker*, 211 Ind. 251, 254-55, 6 N.E.2d 541, 542 (1937).

126. At approximately the same time that courts were looking at a variety of factors in appraisal, the first edition of SECURITY ANALYSIS was released. *See* B. GRAHAM & D. DODD, SECURITY ANALYSIS (1934). The judicial approach was similar to that of these authors. *See, e.g., In re Fulton*, 257 N.Y. 487, 178 N.E. 766 (1931). There the court, in dictum, recognized that market quotations may rise or fall as a result of a proposed corporate action and stated that "[m]arket quotations are, therefore, to be considered only in so far as they reflect a reasonable basis for estimating market quotations which would probably have continued if a sale had not been made." 257 N.Y. at 493, 178 N.E. at 768. Factors identical to those employed in security analysis—dividend rate, regularity of dividend payment, management, and future prospects—were believed to affect market price but were not necessarily accurately reflected in the price. 257 N.Y. at 493, 178 N.E. at 768. The court also recognized that in certain circumstances a corporation in the open market would possess the ability to depress artificially the stock's price. 257 N.Y. at 494, 178 N.E. at 768-69. As for the corporation that faced the prospect of paying the dissenter more than the market price, the court said "[t]he payment of such actual value, even if more than the market quotation, is the price that must be paid by the corporation for the privilege of requiring a sale over the protest of the dissenting stockholders who are in effect being ousted from the corporation." 257 N.Y. at 494, 178 N.E. at 768-69.

For the judicial approach to tax valuation during the depression, see *Rogers v. Strong*, 72 F.2d 455, 457 (3d Cir.), *cert. denied*, 270 U.S. 621 (1934) (rejected market quotations); *Universal Ins. Co. v. State Bd. of Tax Appeals*, 118 N.J.L. 538, 193 A. 915 (1937), *affd.*, 120 N.J.L. 185, 198 A. 836 (1938), *affd.*, 307 U.S. 313 (1939) (theory that market price is "the invariable test of true value under all circumstances" was rejected; "market value is a workable, but not an invariable test of true value. 'It [market value] is nothing more than a convenient index and evidence of true value under ordinary and normal conditions'"); *State v. West Point Mfg. Co.*, 236 Ala. 467, 469, 183 S. 449, 451 (1938).

127. *See* note 65 *supra*.

128. Although the New York courts relied heavily on market price, their decisions recognized the possibility that in certain circumstances market price may not be reliable. *See, e.g., In re Behrens*, 61 N.Y.S.2d 179 (Sup. Ct. 1946), *affd.*, 271 App. Div. 1007, 69 N.Y.S.2d 910 (indicated weight given market price is a function of the nature and extent of the market); *Jones v. Healy*, 184 Misc. 923, 55 N.Y.S.2d 349 (Sup. Ct. 1945), *affd.*, 370 App. Div. 895, 62 N.Y.S.2d 605, *appeal denied*, 270 App. Div. 998, 64 N.Y.S.2d 170 (1946); *In re Shipway*, 29 N.Y.S.2d 590 (Sup. Ct. 1941) (rejected the use of market quotations; court was influenced by the fact that market price had been bid upward by the prospect of a merger).

In In re Marcus, 191 Misc. 808, 77 N.Y.S.2d 529 (Sup. Ct.), *modified on appeal*,

market price would be used only when the market was an active, deep, and fair exchange reflecting the judgment of voluntary buyers

273 App. Div. 725, 79 N.Y.S.2d 76 (1st Dept. 1948), *affd.*, 302 N.Y. 881, 100 N.E. 2d 55 (1951), a very deep and active market existed for the shares in question. On appeal, the court noted that the nature of the market would justify using the prevailing quotations as the appraisal value: "Market value is the controlling consideration where there is a free and open market and the volume of the transactions and conditions make the market a fair reflection of the judgment of the buying and selling public. Nearly all the cases in which other factors have been given much weight have been cases where the market was not sufficiently broad or established to be accepted as representative." 273 App. Div. at 727, 79 N.Y.S.2d at 78. The court noted that the petitioner had not suggested any infirmity in the market which could impair the validity of the prevailing market price. 273 App. Div. at 728, 79 N.Y.S.2d at 78. While generally accepting market price, the court indicated that appraisers were not confined to this single standard but could take other factors into consideration. 273 App. Div. at 730-31, 79 N.Y.S.2d at 81. *See also In re Deutschmann*, 281 App. Div. 14, 116 N.Y.S.2d 578 (1st Dept. 1952) (court held that the dissenters' failure to accept AT&T's offer to buy their stock at a price a fraction above the prevailing NYSE market price was arbitrary, vexatious, and in bad faith. Thus, the court required the stockholders to assume the costs of the proceeding; the court indicated that the stock had a value equal to its price on the market, 281 App. Div. at 19, 116 N.Y.S.2d at 582); *accord*, *Leighton v. American Tel. & Tel. Co.*, 397 F. Supp. 133 (S.D.N.Y. 1975); *In re Kaufmann, Alsberg & Co.*, 15 App. Div. 2d 468, 222 N.Y.S.2d 305, 307 (1961); *Tabulating Card v. Leidesdorf*, 32 Misc. 2d 720, 723, 223 N.Y.S.2d 652, 657 (Sup. Ct. 1961); *Dynamics Corp. of America v. Abraham & Co.*, 5 Misc. 2d 652, 166 N.Y.S.2d 128 (Sup. Ct. 1956) (dictum). *See also* *Application of Silverman*, 115 N.Y.S.2d 97 (Sup. Ct. 1952), *modified on appeal*, 282 App. Div. 252, 122 N.Y.S.2d 312 (1st Dept. 1953) (dictum) (court indicated that market price on a listed exchange could be of great significance, but expressed concern that market price may not reflect the true value of the dissenter's stock as a part of the old enterprise unaffected by the proposed corporate action).

Delaware was the first state to adopt the stock-market exception rule, thereby making market price the exclusive determinant of value. It is ironic then that decisions in Delaware in the post World-War II era recognized considerations that would require national securities exchange prices to be adjusted. *See, e.g., Tri-Continental v. Battye*, 31 Del. Ch. 523, 74 A.2d 71 (1950) (dictum) (court explained that value under the Delaware appraisal statute means the "true or intrinsic value" of the stock, which involves many factors and elements, such as market price, asset value, dividends, earnings prospects, etc.; market value may not be taken as the sole measure of the value of the stock); *In re General Realty & Util. Corp.*, 29 Del. Ch. 480, 52 A.2d 6 (1947) (in accordance with earlier Delaware decisions that weighted a variety of factors in determining the value of stock in close corporations, the court, even though the stock was listed on the NYSE, weighted asset value at 50 per cent, and arrived at an appraisal value higher than market price); *Jacques Coe & Co. v. Minneapolis Moline Co.*, 31 Del. Ch. 368, 75 A.2d 244 (1950); *see also* *Levin v. Midland-Ross Corp.*, 41 Del. Ch. 276, 194 A.2d 50 (1963).

Decisions in other states prior to the advent of the stock market exception rule generally follow the analysis in the New York and Delaware decisions. *See, e.g., Gallois v. West End Chem. Co.*, 185 Cal. App. 2d 765, 8 Cal. Rptr. 596 (1960) (price on over-the-counter market exclusive, *unless* dissenter could provide evidence of abnormality; rejected notion of intrinsic value); *Bauman v. Advance Aluminum Castings Corp.*, 27 Ill. App. 2d 178, 169 N.E.2d 382 (1960) (price on Midwest Stock Exchange not exclusive); *General Grain v. Goodrich*, 140 Ind. App. 100, 221 N.E.2d 696 (1967) (dictum); *Robbins v. Beatty*, 246 Iowa 80, 67 N.W.2d 12 (1954) (dictum) (court reluctant to use "the gyrations of the stock market as a conclusive measure of value"); *Martignette v. Sagamore Mfg. Co.*, 340 Mass. 136, 163 N.E.2d 9 (1959) (dictum) (under ideal conditions, market price reflects all aspects of value, but certain conditions may cause market price to be inaccurate); *Bache & Co. v. General Inv. Corp.*, 42 N.J. 44, 198 A.2d 759 (1964) (sustained the use of stock

and sellers.¹²⁹ The decisions of the post-World War II period were of two types: those that rejected market price and analyzed a variety of factors to determine intrinsic value;¹³⁰ and those decisions that rejected intrinsic value, presumed the accuracy of market price, and allowed shareholders to refute the accuracy of the market price by demonstrating the existence of abnormal factors.¹³¹

By adopting the stock market exception, legislatures implicitly expressed considerable confidence in market valuations. Despite this expression of legislative confidence, courts in recent years have been unwilling to abandon the theories of valuation developed in the post-World War II era. For example, the Delaware chancery court refused to use market price as an exclusive determinant in a 1968 case, *In re Olivetti-Underwood*,¹³² that arose after the enactment of the Delaware stock market exception but before its effective date.¹³³

market quotations as the determinant of value; however, if market price reflected the effects of the corporate change to which the dissenter objected, market price would be adjusted); *In re Paterson & Hudson R.R.*, 11 N.J. 403, 94 A.2d 657 (1953); *Dickinson v. Fire Assn. of Philadelphia*, 378 Pa. 396, 106 A.2d 607 (1954) (allowed limited appraisers' inquiry of those factors that "prevent the market price from reflecting the full market value . . ."); *Jeffrey v. American Screw Co.*, 98 R.I. 286, 201 A.2d 146 (1964) (court indicated an actively traded stock could have a value equal to the market price, but left the option open in appraisal to show a market abnormality); *contra*, *Warren v. Baltimore Transit Co.*, 220 Md. 478, 154 A.2d 796 (1959) (price on PBW Exchange exclusive).

Ohio differs from all other states in statutorily defining the value of a share as "the amount a willing seller under no compulsion to sell, would be willing to accept, and which a willing buyer, under no compulsion to purchase, would be willing to pay," OHIO REV. CODE ANN. § 1701.85(C) (Page Supp. 1975). By statute, the actual market price is evidence of market value, and the weight attached to market price depends on the nature of the market. The actual market conditions are therefore subject to any evidence which can be used to determine value. In *Vought v. Republic-Franklin Ins. Co.*, 117 Ohio App. 389, 24 Ohio Ops. 168, 192 N.E.2d 332 (1962), the court stated that in most cases where there was active trading on the NYSE, price would probably be conclusive.

129. See cases cited in notes 130, 131 *infra*.

130. See, e.g., *Tri-Continental v. Battye*, 31 Del. Ch. 523, 74 A.2d 71 (1950); *Jeffrey v. American Screw Co.*, 98 R.I. 286, 201 A.2d 146 (1964).

131. See, e.g., *Gallois v. West End Chem. Co.*, 185 Cal. App. 2d 765, 8 Cal. Rptr. 596 (1960); *Dickinson v. Fire Assn. of Philadelphia*, 378 Pa. 396, 106 A.2d 607 (1954).

132. 246 A.2d 800 (Del. Ch. 1968).

133. The merger occurred in 1963, so the revised Delaware Corporation Law of 1967 did not apply. Even so, under the 1967 revision, the dissenters still would have possessed appraisal rights. Olivetti acquired over 90 per cent of Underwood's stock and would have been able to execute a short-form merger under DEL. CODE ANN. tit. 8, § 253(a) (1975). The owners of shares not owned by Olivetti would have received notice of the merger from Olivetti under section 253(d). Under the revised law, an objecting shareholder can demand payment for the value of his shares, excluding any element of value arising from the expectation or accomplishment of the merger. If the dissenter and the corporation do not agree on value, the dissenter can demand appraisal, described in sections 262(d) to 262(j). The stock market exception is in section 262(k); therefore, any shareholder whose stock would otherwise be denied appraisal by section 262(k) is entitled to appraisal if the merger is carried out pursuant to section 253.

Although the apparent market for the stock was sufficiently broad to fit within the exception, the court concluded that the market price¹³⁴ was unreliable,¹³⁵ and hence accorded the market value a weight of only fifty per cent in determining the final value of the stock.¹³⁶ The philosophy of the stock market exception, of which the court was no doubt aware, was ignored in lieu of other factors believed to offer a more accurate estimate of the fair value of the stock.

An attempted merger in 1971 between Glen Alden Subsidiary Corporation and Schenley Industries gave rise to two Delaware decisions that show a similar reluctance to rely upon market price as an exclusive measurement of value when the stock market exception is inapplicable. In *Greene v. Schenley Industries, Inc.*,¹³⁷ a minority shareholder in Schenley sought to enjoin the merger because of the alleged unfairness of the proposed exchange of Schenley common stock, which was traded on the NYSE, for debentures and cash.¹³⁸ In valuing the Schenley stock to determine the fairness of the consideration, the court indicated that market price was to be given great weight, and relied upon the market's performance in 1970 to establish the plan's fairness. The court noted in passing, however, that the market price during portions of 1967 and throughout 1968 was not an accurate reflection of Schenley's true worth, since competing takeover proposals had inflated the price.¹³⁹ The court thereby indicated that, had the case arisen at that time, it would have looked to other factors to determine the value of the stock. The injunction was ultimately denied, and an appraisal of the dissenter's shares occurred.

134. The Underwood stock was traded on the NYSE until July 2, 1963, when it was delisted, but about 2000 stockholders continued to trade over the counter until the merger occurred on October 23, 1963. 246 A.2d at 801-02.

135. 246 A.2d at 805.

136. 246 A.2d at 809. The court weighed three factors in calculating the intrinsic value of the stock—earnings (\$0) at 25 per cent; market value (\$14.25) at 50 per cent; assets (\$10.62) at 25 per cent—and arrived at a value per share of \$9.78. This value was lower than the market price, which is not surprising since Olivetti bid up Underwood's stock in the acquisition attempt. Interestingly enough, the value per share after the court applied its methodology was only slightly higher than the merger date bid market price of \$9.50. 246 A.2d at 803.

137. 281 A.2d 30 (Del. Ch. 1971).

138. Such an exchange would not fall under the stock market exception rule even if the plaintiff had been seeking appraisal instead of an injunction. The Delaware statute eliminates appraisal only where the shares received as well as the shares surrendered are listed on a national securities exchange or are otherwise actively traded. DEL. CODE ANN. tit. 8, § 262(k) (1975). Contrast MICH. COMP. LAWS ANN. § 450.1761(a) (1973), which denies appraisal when either the shares received in consideration or the shares surrendered satisfy the national securities exchange requirement. Michigan reasons that the Delaware requirement is unnecessary because the dissenter in either case can still sell his stock, because the dissenter assumes the risk of a decrease in value as a result of majority action, and because the minority has other remedies, presumably injunctive relief, if the terms of the merger are unfair. Comment to MICH. STAT. ANN. § 21.200(761)(a) (1974).

139. 281 A.2d at 34.

In *Gibbons v. Schenley Industries*,¹⁴⁰ the dissenters returned to court to challenge the conclusions of the appraiser's report. The appraiser weighted market value at thirty-five per cent, earnings value at forty-five per cent, and asset value at twenty per cent in arriving at a fair value of \$43.87 for the common stock, considerably higher than the \$29 market price for the stock prevailing on the date of the merger. In *Gibbons*, the court believed that market price should be given greater weight,¹⁴¹ and cited the 1967 adoption of the stock market exception for support. However, even though there was a market price available as of the merger date, the court did not rely on it exclusively, but instead weighted market price at fifty-five per cent and earnings at forty-five per cent, and calculated a fair value of \$39.79 for each share. By rejecting market price as an exclusive value determinant, the *Gibbons* court implicitly disaffirmed the theoretical underpinnings of the stock market exception.¹⁴²

In sum, the contention that appraisal affords dissenting shareholders no benefit that sale on the market could not provide ignores the realities of market pricing and the barriers to a dissenter's participation in the market. Unquestionably the stock market exception places many dissenting shareholders in a dilemma from which they can escape, if at all, only by suffering a considerable loss on the disposition of their stock.

Once it is determined that dissenters cannot always receive adequate compensation for their shares by selling on the market, the proponents of the stock market exception can make one final argument—that the appraisal remedy is too costly and too conducive to vexatious suits to justify the benefit it confers on shareholders who hold listed or widely held securities. It is to this contention that the following subsection is directed.

B. *The Costs of Appraisal*

Like all judicial and quasi-judicial proceedings, appraisal of a dissenter's shares can be costly. In weighing the impact of this problem, however, two considerations must be kept in mind. First,

140. 339 A.2d 460 (Del. Ch. 1975).

141. *Chicago Corp. v. Munds*, 20 Del. Ch. 142, 172 A. 452 (1934), *see* note 125 *supra*, was minimized as being "a case decided in an atmosphere of severely depressed market values of corporate shares of stock on a scale much more extreme than that being experienced now . . ." 339 A.2d at 467.

142. The fact that nonmarketable securities were being offered in exchange should not have affected what standard was used to appraise the shares. *See* note 138 *supra*. The stock-market exception is based on the assumption that market price is accurate and can be used as an exclusive determinant of value. Regardless of the consideration offered in the exchange, the dissenter is being compensated for his interest in the old corporation, and the value of his interest should still be the market price. *See* MICH. COMP. LAWS ANN. § 450.1761(a) (1973), *discussed in* note 138 *supra*.

the costs of appraisal are apt to generate vexatious suits, or alternatively to stifle meritorious claims, only if the costs are consistently imposed on one of the parties, because it is only then that the cost factor will increase the bargaining power of one party over the other. Second, the costs are incurred only if an appraisal actually takes place. If the appraisal statute is framed to encourage pre-appraisal settlement, and if the substantive factors used by appraisers to reach decisions are sufficiently clear to enable the parties reasonably to predict the outcomes, appraisal proceedings may rarely occur.

Current appraisal procedures are reasonably conducive to pre-appraisal settlement and, with some minor modifications, can be made even more so. Most state statutes assess the costs of appraisal against the corporation so long as the dissenter acts in good faith.¹⁴³ This practice has not generated a significant number of vexatious suits,¹⁴⁴ and generally appears to comport with the stronger equitable position of the shareholder, who must turn to appraisal to receive the protection forgone by the elimination of his common-law right to enjoin the corporate action.¹⁴⁵ However, most states also allow the court to apportion the costs of the proceeding between the parties if the conduct of the parties renders it appropriate.¹⁴⁶ Meaningless suits are discouraged by the fact that a dissenter who presents a claim in bad faith can have the full costs of the proceeding assessed against him. The same prospect encourages the corporation to cooperate in the proceeding, to make fair settlement offers, and to avoid actions that might depress the price of the stock. Thus, the prospect of having fees assessed against them encourages both parties to arrive at a pre-appraisal settlement.

One possible argument against this cost apportionment scheme is that a dissenter who is forced to assume some share of the costs will receive less than the full value of his shares.¹⁴⁷ But this argument has little force, since a dissenter will incur costs generally only if he acts in bad faith. Moreover, it is hardly unique to the appraisal

143. See, e.g., ME. REV. STAT. ANN. tit. 13-A, § 909.9.(H) (1973); N.Y. BUS. CORP. LAW. § 623(h)(7) (McKinney 1963); VA. CODE ANN. § 13.1-75(f) (Supp. 1975).

144. Although isolated instances of shareholder harassment of the corporation can be found, see *In re Marcus*, 273 App. Div. 725, 79 N.Y.S.2d 76, rehearing and appeal denied, 274 App. Div. 822, 81 N.Y.S.2d 199 (1948), the nuisance value of appraisal actions is relatively small. N. LATTIN, *THE LAW OF CORPORATIONS* 592 (2d ed. 1971). Most criticism of appraisal has focused on its high cost to the user and its overly complicated procedures. See Manning, *supra* note 20, at 233. Cf. *Waite v. Old Tucson Dev. Co.*, 22 Ariz. App. 517, 528 P.2d 1276 (1974). This criticism, if valid, suggests that stockholders would not bother to use this inconvenient procedure in bad faith or for purposes of harassment.

145. Pierce, *supra* note 15, at 156-57.

146. See, e.g., DEL. CODE ANN. tit. 8, § 262(h) (1975); N.C. GEN. STAT. § 55-113(e) (1975). See also LA. REV. STAT. ANN. § 12:131(G) (West 1969).

147. Pierce, *supra* note 15, at 155.

context that an individual must incur expenses in order to assert a legal claim. In any event, transaction costs connected with selling stock on the market pursuant to the stock market exception also prevent the shareholder from receiving full value.

Pre-appraisal settlement is also encouraged by procedures that facilitate bargaining between the corporation and the dissenter. All appraisal statutes require that some effort be made by the corporation and the stockholder to agree on a price without going to court.¹⁴⁸ For example, the New York statute places an affirmative burden on the corporation to make an offer to the dissenter.¹⁴⁹ If the parties reach no agreement based on this offer, then procedures are initiated whereby the values are determined by the court or by the appraisers.¹⁵⁰ If no agreement has been reached due to the bad faith of either side, costs and expenses may be imposed on the recalcitrant party,¹⁵¹ and interest to the shareholder may be denied.¹⁵² Proposed amendments to the Model Business Corporation Act require the dissenter who disagrees with the corporation's offer to demand a supplemental payment.¹⁵³ The Act assigns costs to the corporation, but grant the court discretion to impose them on the dissenter after considering various factors relevant to his good faith.¹⁵⁴

In any legal context, parties are most likely to reach a settlement if the substantive law is well defined and the parties can reasonably predict the outcome of the litigation. Although this proposition is no less true in the appraisal context than elsewhere, appraisal proceedings have long possessed an unpredictableness that encourages further litigation. Clarification of the substantive considerations that are regularly to enter into the appraisal of shares would substantially reduce the incidence of actual resort to the appraisal remedy, and would thereby reduce the costs a shareholder must incur in exercising his legal rights.

One way of clarifying the substantive law of appraisal in the context of widely traded stocks is, as noted above,¹⁵⁵ to place a

148. *Id.* at 147.

149. N.Y. BUS. CORP. LAW § 623(g) (McKinney Supp. 1975). The offer must be accompanied by a balance sheet giving information about the corporation's value.

150. N.Y. BUS. CORP. LAW § 623(h) (McKinney 1963).

151. N.Y. BUS. CORP. LAW § 623(h)(7) (McKinney 1963).

152. N.Y. BUS. CORP. LAW § 623(h)(6) (McKinney 1963).

153. SUBCOMMITTEE, PRELIMINARY DRAFTS OF AMENDMENTS TO MODEL BUS. CORP. ACT §§ 73, 80, 81 (Nov. 17, 1975) at 21; SUBCOMMITTEE, PRELIMINARY DRAFTS OF AMENDMENTS TO §§ 79, 80 and 81 of the MODEL BUS. CORP. ACT (Feb. 11, 1976) at 13.

154. Such factors could include whether the corporation made an offer, or the amount by which the corporation's offer fell below, or the dissenter's demand exceeded, fair value. SUBCOMMITTEE, PRELIMINARY DRAFTS OF AMENDMENTS TO MODEL BUS. CORP. ACT §§ 73, 80, 81 (Nov. 17, 1975) at 23.

155. See text at notes 77, 78 *supra*.

presumption of accuracy on the market price and to allow the dissenter to show what special factors, if any, distorted the accuracy of the market valuation. A statute or court decision that limited the dissenter to showing the existence and effect of these factors would substantially eliminate the inequities of the stock market exception, while streamlining the appraisal process considerably.¹⁵⁶

III. CONCLUSION

Several modified forms of the stock market exception have been proposed in an effort to reduce the inequities of the exception as it exists in most states. California has adopted one such proposal¹⁵⁷ that limits the exception to those exchanges that have been certified by the state Commissioner of Corporations. By wisely exercising his discretion, the Commissioner can presumably exclude those regional exchanges that are characterized by market thinness and by other problems of inefficiency. The new law also provides that only holders of those over-the-counter stocks on the list compiled by the Board of Governors of the Federal Reserve System will be denied appraisal. This provision is designed to keep thinly traded stocks from falling within the exception. Also excluded are securities restricted by any federal or state law or regulation. Moreover, appraisal is granted if five per cent or more of the shares dissent. This provision attempts to mitigate the inability of dissenters to sell their shares without depressing the market price. The choice of the five per cent figure is arbitrary, since the depressive effect of a particular sale depends on a variety of factors unrelated to the amount of the dissenter's stock. For example, the level of activity in the stock is relevant; if a large percentage of the float is held in long-term investment portfolios, or if the volume of trading is evenly dispersed among the various exchanges, a sale of considerably less than five per cent might depress the market price.

The innovative California statute reduces some of the harshness of the stock market exception, but it suffers from one shortcoming that is inherent in any version. The dissenter who fits within the rule still must sell his shares on a market that has already reacted to the corporate action to which he dissents. Thus, the California statute fails to give the dissenter the full value of his interest in the original

156. Some courts have utilized appraisal in this manner. *See, e.g.,* Martignette v. Sagamore Mfg. Co., 340 Mass. 136, 163 N.E.2d 9 (1959) (dictum); Bache & Co. v. General Inv. Corp., 42 N.J. 44, 198 A.2d 759 (1964); *In re McKinney*, 116 N.Y.S.2d 375, *revd. on other grounds*, 280 App. Div. 723, 117 N.Y.S.2d 124 (1952), *affd.*, 306 N.Y. 207, 117 N.E.2d 256 (1954).

The Ohio statute has been construed to produce this result. *See* note 128 *supra*. The Oklahoma statute appears to require this result. *See* note 3 *supra*. *See generally* note 128 *supra*.

157. *See* note 5 *supra*.

corporation when the corporate action is improvident. Intuitively, it would seem that protecting the original investment of the dissenter while allowing the majority to make the decisions is a fair resolution of the competing interests of the minority and the corporation's management. Moreover, if legislatures desire to encourage investment as a matter of public policy, they should protect investors from being unnecessarily surprised by changes in the nature and value of their investments. Giving the dissenter the value of his interest in the old corporation minimizes surprises and thereby creates an environment conducive to investment.

Another alternative, which was considered and rejected by the Law Review Commission of Michigan, is to eliminate appraisal for a listed security only where the market price falls by less than a stated percentage (the Michigan figure was twenty-five per cent) during the interval between the announcement of the corporate action and the record date for voting.¹⁵⁸ There are several problems with this alternative. If the market anticipates the action even before it is publicly announced and adjusts its price at that time, any measurement of the reduction in the post-announcement period is meaningless. Furthermore, even a twenty-five per cent drop in price is a considerable loss for the dissenter to bear. On the other hand, any reduction in the percentage that the market price must fall to trigger appraisal would tend to grant appraisal even when price reductions resulted from factors unrelated to the dissent.

Another suggested modification in the appraisal mechanism provides for an arbitration proceeding that does not directly involve a court.¹⁵⁹ As envisaged, however, arbitration hardly differs from an appraisal proceeding where the appraisers have absolute authority to determine value. Though arbitration is often thought advantageous because it saves the expense of a court proceeding and takes less time, it is doubtful that arbitration in the appraisal context has any of these benefits. A court expends little time in appointing a panel of experts to appraise the stock and in entertaining exceptions; appeals from arbitration decisions may be equally time-consuming.¹⁶⁰ Moreover, the expenses of assembling and presenting evidence would be substantially the same in either context.

Any statute that requires the dissenter to sell on the market risks depriving the dissenter of the full value of his shares. Accordingly, a statute should allow a panel of experts to adjust the market price in a proceeding that avoids placing intolerable burdens on either party. A

158. Siegel, *The Proposed Michigan Business Corporation Act*, 4 U. MICH. J.L. REF. 161, 177 (1970).

159. See SUBCOMMITTEE, REPORT OF PROGRESS AND REQUEST FOR INSTRUCTIONS 3 (Sept. 8, 1975).

160. Cf. MICH. GEN. CT. R. 769.9 to .10.

modified appraisal procedure appears to offer maximum utility. Shareholders should be required to object to the proposed corporate action before or during the meeting at which the vote on the action is taken, so that the corporation has adequate notice of the dissent¹⁶¹ and of the number of shares that might have to be repurchased. Shortly after the corporate action is approved, the shareholder should also be required to make an irrevocable demand for payment. A valid concern is that the dissenter might be able to press the corporation for a favorable payment while leaving himself the option of selling his shares on the market if the price should rise. This possibility can be avoided by requiring the shareholder to surrender his shares to the corporation as evidence of his intention to dissent.¹⁶² After the dissenter surrenders his shares, the corporation should be required either to determine the fair value of the shares and pay the dissenter that value in cash,¹⁶³ or to return the shares to the dissenter, with instructions that he must sell them on the market.¹⁶⁴

Whether the shares are repurchased or sold on the market, the shareholder should be allowed to demand a supplemental payment if he questions the corporation's determination of the value or the value he received by selling on the market. If the corporation and the shareholder cannot agree on the amount of the supplemental payment, an appraisal proceeding would be held to determine the pro-

161. This is the current position of the Model Business Corporation Act. See 2 MODEL BUS. CORP. ACT ANN. § 81 (1969).

162. The Model Business Corporation Act currently provides that if the proposed corporate action is approved by a vote of the shareholders, the shareholders have ten days in which to make an irrevocable demand for payment. See 2 MODEL BUS. CORP. ACT ANN. § 81 (1969), at ¶ 2.

A proposed revision to the Model Act requires the dissenter to surrender his shares within 20 days if the proposed corporate action is passed. This informs the corporation at an early date of how many shareholders are dissenting. It also avoids the possibility of dissenters selling their shares to speculators hoping to profit on developments in the subsequent course of the appraisal proceeding. SUBCOMMITTEE, PRELIMINARY DRAFTS OF AMENDMENTS TO §§ 79, 80 and 81 OF THE MODEL BUS. CORP. ACT (Feb. 11, 1976) at 12, 17.

Moreover, even if the dissenter sold or assigned his interest in a share to a third party after surrender, so long as the standards used to determine the proper value of a share are relatively certain, the new owner would have only the same leverage as the prior owner. Accordingly, the corporation's interests would not be affected.

163. Such a provision is included in proposed amendments to the Model Act. See SUBCOMMITTEE, *supra* note 162, at 13.

164. See text at note 49 *supra*. The sale of a block of restricted securities, unless privately placed, would involve registration costs. If not forced to sell his shares quickly, the shareholder would probably sell his stock pursuant to rule 144 in small quantities over a long period of time so as to avoid the high registration expense. See note 103 *supra*. Accordingly it would be necessary to make some sort of equitable apportionment of registration costs to ensure that the dissenter received the full amount of what would have been his proceeds but for the appraisal. Normal transaction costs, for example, should be assumed by the dissenter and not by the corporation, since these costs would reduce net recovery even if there were no forced sale.

priety and amount of such a payment.¹⁶⁵ In determining the amount of the supplemental payment, the appraisers should calculate the difference between the actual value of the shares and, as appropriate, either the corporation's assessment of value if the shares were repurchased or the price that was obtained through sale on the market. As discussed earlier,¹⁶⁶ the appraisers should presume the validity of the market price and limit their inquiry to factors that may have distorted that value. One possible argument against such a scheme is that all dissenters will request a supplemental payment, thereby subjecting the corporation to vexatious suits. However, assessing costs against the dissenter if his claim is made in bad faith should deter such demands, if indeed the legal costs of dissenting do not already accomplish this.¹⁶⁷

Such a statutory framework offers several compelling advantages. The dissenter receives early payment for his shares and avoids the costs of having his investment tied up for the duration of the proceedings. Moreover, the corporation, which at the time of surrender is informed of the extent of the dissent, is given the option of repurchasing the shares or having them sold on the market. As discussed earlier,¹⁶⁸ the latter option allows the corporation to pay only the difference between the market price and the appraisal value, and thus to avoid any cash-flow problems connected with a massive repurchase effort. Furthermore, the dissenter who receives early payment may in fact be satisfied with his recovery and decline to seek a supplemental payment. Finally, avoidance of the vicissitudes of a market sale altogether enhances the ability of the dissenter to receive the full value of his shares.

165. The demand for a supplemental payment is contemplated in proposed revisions to the Model Act, SUBCOMMITTEE, *supra* note 162, at 14.

166. See text at notes 77, 78 *supra*.

167. See text at notes 146-54 *supra*.

168. See text following note 49 *supra*.